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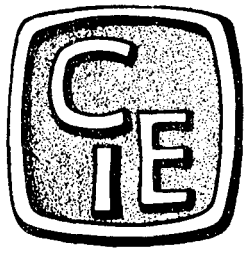

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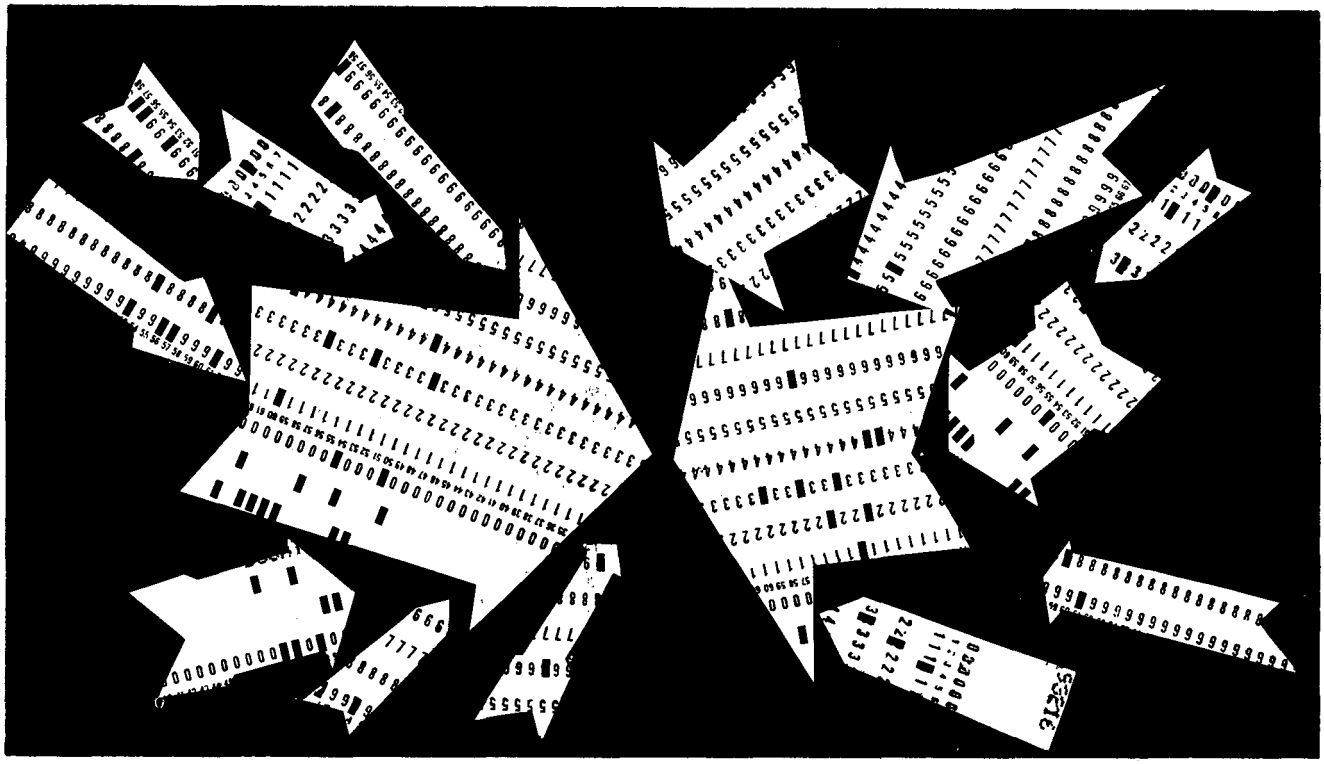

the data communications battle

michael e bloom

CAVEATS

The "data communications battle" is *not* the sole possession of the third quarter of the twentieth century: neither the concept nor the cast of characters is unique. Most discouraging of all the tenets involved in the current feud is the realization that all this has happened before and has happened in the same foible-shrouded milieu. The principals of the current flourish of rhetoric—the American Telephone and Telegraph Company (AT&T) and the several "independent" telephone companies of the United States (collectively known as common-carriers), private businessmen engaged in enterprises akin to those of common-carriers but not licensed as such, federal and state governments and/or agencies, and the consumer of the purveye d services—have changed in only a limited fashion during the first and second rounds of this checker game. They remain, however, constant in that the *individual consumer* is on one end, *purveyors of services* (ranging from the fully regulated common-carriers to the manufacturers who are required to design and build equipment to meet regulated specifications) are on the other, and some form of governmental function attempting to act as liaison/regulator/disinterested party is in the middle.

FCC

On 25 May 1971 the Federal Communications Commission (FCC) handed down another of its "historic decisions." This one was primarily concerned with the rate and pricing structure(s) it would allow for common-carriers, but it was brought about through the insistent cries of a small group of corporations. These corporations had not been dealt the legalized monopoly protections of common-carriers but had nevertheless sought to provide services in a market where (they allege) the common-carriers have not succeeded in providing services to a small but rapidly-growing number of consumers. The service involved in the current controversy is the provision of data communications facilities—facilities which enable one computer to "talk" (transmit data) to one or more other computers or to communicate between input and output terminals (such as teletypewriters) with or without computers. For almost a century, transmission of such data among end-users (such as the early telegraph operators at railroad stations) has been virtually the sole responsibility of common-carriers (telephone companies); the major exception has been the actions by some railroad and oil companies to establish and maintain their own lines. The admissibility of private firms other than common-carriers (such as oil and railroad companies) to the small group of companies providing transmission service may seem, at the outset, significant. The difference which initially allowed such firms to establish their own communications systems has become the nexus of

the current argument before the nationwide regulator of these services—the FCC.

The distinction is that (1) the railroads, for instance, built, maintained, and paid for their own lines, including remuneration for rights-of-way over non-railroad-owned properties, (2) the only communications traversing these lines were railroad company communications and (3) the railroads were, in addition, *not* providing a "switched-service system"—that is, a system in which any one end-user could communicate with any other end-user through switching devices. A nonswitched system is feasible, of course, for railroad companies, since they have a finite number of end-users, and they are *sure* of the growth rate per annum in number of users: telephone companies can only make guesses (although very well-educated ones) about the number of users and can only extrapolate, on the basis of many parameters, the number of users to be added or removed from the system in any given year.

The picturesque data communications market at the turn of the century, with firearm-laden cowpokes braving the wilds of western North America to get the railroad (and its communications links) through to establish some "civilization" west of the Columbia Gap, has grown phenomenally in the years since then. But the most significant growth has been in the past fifteen years, increasing communications traffic by *orders* of magnitude. Businesses have found an avenue (and, in some cases, even a need) for transmitting their daily transaction reports, inventory summaries, and corporate memoranda, *inter alia*, between and/or among branch offices and corporate headquarters: credit-card companies, and companies which do business utilizing credit cards, daily transmit reams of information detailing lost/stolen cards, attempted frauds, and account statuses to a central computation center and thence (in some cases) to every card-honoring retail outlet in the country! But while these businesses may utilize their communications links intensively from midnight to six a.m. daily, they might have little or no use for those lines during the day; further, during the day they may wish to communicate with other businesses which they need not contact during the midnight-to-six period. If the businesses involved do not happen to be fond of paying for services they will not use, a demand will arise for rates commensurate with the need for certain facilities at certain times of the day and for certain durations.

COMPETITION

Intransigence on the part of common-carriers (notably AT&T, by whose rates most of the non-Bell common-carriers in the country abide), to modify rate structures for the benefit of businesses who wanted primarily information transmission and not voice communication and only at certain times of the day, were the prime factors in motivating Jack Goeken, a young entrepreneur from Joliet, Illinois, into forming Microwave Communications Incorporated (MCI) and filing an application with the FCC for a specialized common-carrier communications system between Chicago and St. Louis.

Since Goeken's 1963 application, there have been three categories of occurrences bearing upon long-distance (as opposed to intra-city) data communications:

(1) By 30 June 1970, less than seven years from MCI's application, a total of 1,713 applications for similar systems or expansions of MCI's system were before the FCC;

(2) The three major common-carriers in the nation—AT&T, General Telephone and Electronics, and Western Union—rapidly shifted gears and began readjusting their rate structures to be competitive with those offerable by MCI and most of the other 1,712 applicants; and, most significantly,

(3) AT&T which, of the three, has the most resources upon which to draw, began via its army of corporate lawyers to file with the Commission a large number of "points of inquiry," requesting that the Commission make a ruling based upon the apparent facts and the three carriers' (but primarily AT&T's) long record of dependable service to telephone and data users in the country—these points often bordering upon requests for the FCC's *flat denial* of the specialized common-carrier concept.

On 25 May 1971 the FCC finally made its full position known. Influenced, no doubt, by the December 1968 report of the President's *Task Force on Communications Policy*, which endorsed the *specialized* common-carrier concept, the FCC determined that AT&T's virtual monopoly of private line communications service was at an end. The Commission authorized competition for specialized communications by means of varying rate structures and offered features. As summarized by the *WASHINGTON POST* News Service on 27 May, "The decision constitutued an indirect admonition to AT&T and Western Union that they have not been quick enough to introduce technological and service innovations." With the announcement of the FCC's decision, those two giants issued "conciliatory statements" noting that they would probably not initiate court action to appeal the Commission's unanimous decision.

By approximately the time of the decision, the Commission had on file some 1,900 applications from 33 separate firms to establish such specialized common-carrier services. Notable among these was a set of applications from firms whose conceptual approach was the same as MCI's but whose operational system had a slightly different tenor. The leader among these is Data Transmission Company (Datran), a subsidiary of University Computing Company, which, if its capital holds out, will endeavor to establish a nationwide "dialing service" for computers, through which any one computer linked to the system could interconnect with any other computer on the system. Designed exclusively for data transmission, rather than the multi-purpose use proposed by such companies as MCI (whose systems provide a more direct competition for AT&T's Long Lines Division), Datran's system would be primarily digital microwave, using computers as switching devices. While the regulatory door has now been truly opened for competition in communications systems, it appears that the FCC may well be headed down the same path it has traversed twice before.

ROUND ONE—RADIO

The first time American society encountered the user-purveyor-regulator communications triangle was at the dawn of modern devices with the development of wireless communications at the turn of this century. Chronologically, the pattern was initiated by Scottish physicist James Maxwell in 1864 (theories of electromagnetism and electric wave theory), Thomas Edison's experiments in wireless land communication systems for railroads (circa 1884), German physicist Heinrich Hertz' development of electromagnetic propagation (radio waves) through space in 1887, Guglielmo Marconi's investigations in 1894 of telegraphy without wires based upon Hertzian principles, and the development of the vacuum tube (1904-1908) by British electrical engineer Sir John Ambrose Fleming, Canadian Reginald Fessenden, and American Dr. Lee De Forest.

JEALOUSIES

Each of these pioneers was extremely jealous of the others and sought to develop his own contribution into a viable enterprise. And so, beginning with Marconi in 1897, a plethora of patents, infringement rights, paper corporations, holding companies, and licensing agreements evolved. From this quaint mess emerged the corporate electrons of the twentieth century: American Telephone and Telegraph Company, Western Electric Company, General Electric, the Radio Corporation of America, and Westinghouse, among others. The early electronic equipment manufacturers (primarily limited to radio receivers) were severely bogged down until military operations came to the rescue during World War I. The government then asked all the companies to pool their resources and inventions to facilitate tactical communications systems development in exchange for legal protection against patent suits. Prior to this, each manufacturer had needed basic patents which were controlled by its competitors, each had refused to license the others, and thus, if any was to continue its operations, it would likely have become vulnerable to patent infringement suits.

The solution? Not quite. Adding to the mess was the fact that the ingenious Marconi had established the British Marconi and American Marconi Companies which, through cross-licensing, held rights to virtually every useful device or concept required by fledgling GE to produce radio sets. GE therefore developed a plan for a new company, to be controlled entirely by American capital, to gain control of a significant bundle of the major radio patents. Formed in 1919, the Radio Corporation of America had the funds to purchase all of the patents and assets of American Marconi and entered into cross-licensing agreements with GE, Westinghouse, and Western Electric. Needless to say, it took a commanding lead in the American radio field. Under the agreements, GE and Westinghouse held the exclusive right to manufacture radio receivers, RCA was the sole selling agent for the sets, and AT&T (through its manufacturing subsidiary, Western Electric) was granted the exclusive right to make, lease, and sell broadcast transmitters. In exchange, the various companies were awarded substantial stock holdings in RCA. These were true monopolies, developed with the covert blessing of and licensed by the federal government; and the were deemed additionally to be proper, since they ensured the colonies a place in the sun without relying upon developments made in and capitalized upon by the United Kingdom. Little thought was given, though, to the eventual consequences of such a series of moves.

AT&T constructed and operated radio station WEAF (now WNBC) in New York City. This high-powered operation was set up by the company to operate as a "toll" station and became the medium for the first commercially-sponsored program in the United States, holding the broadcast of a ten minute talk sponsored by the Queensboro Corporation (a Long Island realty company) on 28 August 1922. By this time, some far-sighted individuals (but few corporations) could begin to glimpse what was looming on the horizon. The stage was set, however, for the onslaught of technological and philosophical protagonists, almost all of whom thought they had "the answer" and consequently knew in which direction this new medium should go: the preliminaries became arguments for (1) the need to explore all of the possibilities of the medium before it was permitted access by the public (e.g., licensing of broadcast stations to private firms), (2) the need not to let the country go another second when they could be taking advantage (cf., "the people have a right to knowledge") of such a marvelous tool, (3) the manifest needs of the military, which, incidentally, never took a back seat to the development of the industry for civilian uses but can, nevertheless, be credited with encouraging many of the technological developments of the medium, and (4) the businessmen and corporations who saw the opportunity to capitalize on what they perceived to be the yearnings of the populace.

UNCLE SAM, THE RADIO MAN

The first attempt at federal regulation of wireless communications came with the Wireless Ship Act of 1910, forbidding any large, passenger carrying vessel to leave a U.S. port without adequate communications equipment and a skilled operator. In 1912, the United States became party to the first international radio treaty, when Congress vested licensing powers for the United States with the Secretary of the Commerce. Regulation of broadcast stations and their frequencies, locations, and hours of operation was initially unsuccessful. A 1926 ruling by an Illinois federal district court held that the Secretary had no power to impose restrictions upon stations [1]. Later that same year the U.S. Attorney General issued an opinion along the same lines [2]. And the Secretary of Commerce, Herbert Hoover, was caught in the middle. "Completely frustrated . . . Hoover issued a public statement abandoning all his efforts to regulate radio and urging that the stations undertake, through gentlemen's agreements, to regulate themselves"[3].

Hoover had been called on the carpets for ministrations under the aegis of the 1910 and 1912 Acts. Rather than continue with the legal battles thereunder, and to provide a more cogent definition of the regulatory nature they sought to provide, Congress provided the Radio Act of 1927. The new 1927 Act, plus its successor, the Communications Act of 1934, gave teeth to the regulatory concept, primarily through more explicit legislation. These latter Acts were spawned, however, only after a short period of confusion in the broadcasters' scramble for radio frequencies: everybody wanted one, and nobody (since the fiascoes Hoover encountered) was going to oversee the frequencies' distribution. Enterprising businessmen would simply build a transmitter and some semblance of a studio and go on the air. In this early period of experience with wireless communications, the courts were beginning to develop approaches to defining competing interests in the air waves. However, the passage of the 1927 Act prevented the courts from applying their own emerging solution to the new problems presented by broadcasting, and imposed a regulatory approach upon a problem not yet really fully understood. [4]

The 1927 Act, in point of fact, was the first time a "freeze" was placed upon broadcast licenses—soon after enactment, all licenses were withdrawn, and sixty days were allowed for the submission of new applications, in order to give, as much as feasible, an "equal" footing to all applicants in the new allocation. The Federal Radio Commission, the agency established by the 1927 Act, was empowered to process and coordinate all of these applications (much as Hoover had attempted to do earlier), allocating frequency (location on the dial), power, and hours of operation to all but some 150 applicants (which were granted a special immunity, primarily based upon their tenure).

Through the 1934 Act, the FCC was established. This new agency was mandated the same scope of responsibilities as the Federal Radio Commission, except that it additionally was given control over wire communications in the form of regulation of telephone and telegraph companies. With the dawn of the FCC came the attempt to exercise control over all communications media and the possible realization by the government that conceptual orientation was more significant than a functional/operational approach. Although no dicta exist to this effect, it may be postulated that since radio was initially developed as a means of telegraphic communication without wires, it may have been thought that areas of interest in radio could be reflected back to the wire communication complexes. The latter, however, were not envisioned to be a significant problem at the time, since AT&T owned or manufactured virtually all wire communications devices and systems and the few independent (non-AT&T) companies that did exist could, in terms of technological feasibilities, always be connected to some portion of AT&T's system. The organization which was formed in 1901 with a capitalization of some $250 million—the American Telephone and Telegraph Company—had spanned an era including the labor pangs of the birth of wireless communications [5]. They were still involved in both media, and they would continue to be so.

ROUND TWO—TELEVISION

The television station license application moratorium of 1948 to 1952 (known as "the big freeze") did not come about quite as suddenly as the chaos in radio. In fact, the 1939 preview of television at the New York World's Fair came nearly 50 years after the original technological work had been done. The prenatal days of television seems to be around 1884, when the German scientist Paul Nipkow invented a scanning disc which made future developments possible. In 1923, Dr. V. K. Zworykin patented the forerunner of today's television camera, the iconoscope. The integration of radio and television technology took place primarily in the laboratories of RCA, CBS, and DuMont, rather than what might be expected in terms of technology transfer among independent researchers. Most significant about the evolution of television is the fact that this time, corporate capital was being ventured for these developments, in the hope that a commercially-viable product could be produced. It was not the demonstration of private venture capital by well-heeled inventors or their philanthropists attempting to, among other interests, advance science. The 1948 freeze was brought upon the industry primarily due to its headlong uncontrolled rush to get that first set into that first household—even if it did cost nearly $1,000 (1940s prices!) to purchase. The issues with which the FCC had to deal during the freeze revolved around the prescription of a technical standard for the transmission of video information and, attempting to read its crystal ball, how this standard could be eventually extended to include broadcast of color information without modification of television receivers and another potential "freeze." The corporate agents of influence and change in this case were not the established common-carriers or those who had been in the communications business, whether wired or wireless, before, but they included relative newcomers to telecommunications: the DuMont Laboratories, the Columbia Broadcasting System (the last independently-established network), and the Radio Corporation of America.

Although only three of the six major purveyors of broadcast programs since the birth of radio (American Broadcasting Company, AT&T, CBS, DuMont Laboratories, Mutual Broadcasting System, and the National Broadcasting Company as a subsidiary of RCA) were working on the development of television, and the FCC had been noticeably and unusually responsive to the problems plaguing the industry, the physical (i.e., electrical) establishment of networks was almost excruciatingly slow in realization. AT&T did not complete the transcontinental network hookup until September 1951. The nearly 17 million television sets in American households by the end of the freeze had been receiving their "network" programs virtually entirely by kinescope, a film reproduction process by way of which programs were transported from coast to coast, somewhat as video taped programs are now recorded and stored. Kinescopes were produced at a network facility on one coast (usually the East), flown by commercial airliner to other stations, and shown on a local-only basis, as if it were a live program (since networks for video transmission had not yet been established).

Why AT&T was so lethargic in establishment of the transcontinental video network can only be guessed at, but it is probable that, conservative as she is of her resources and hesitant as she is of making incorrect moves that will impinge upon her revenues, "Ma Bell" waited until standards for transmission *through the air* were well-detailed and the precise amount of the spectrum which each television channel would utilize was specified before she made a commitment to the nationwide hookup. Another possible consideration is that long-range video transmission was no simple technological task (even today, these networks boggle the mind of many an engineer), and AT&T could not guarantee the fidelity and picture quality that the networks demanded; so, rather than provide inferior service, she provided no service at all.

ROUND THREE—DATA COMMUNICATIONS

We come now to the communications complex of the 1970s. The United States again hears cries of "restraint of trade" and "protection of public utilities." Whether communications common-carriers are public utilities has been argued by legal giants in the hearing rooms of virtually every public utilities commission in the country; but rather than cite chapter and verse of this multitude of barristers' briefs, it is fair to say that a communications common-carrier is considered *de facto* a "public trust." The common-carrier has been granted what the public utilities commissions term a "legal monopoly." This is where the waters part in the decision by a given regulatory agency: one corporation shall be franchised to do business, while others are legally excluded from business. The rationalization for granting of such monopolies has been a rather simple argument: Corporation A has the capital to proceed with certain installations of equipment or purchases of existing equipment and petitions the regulatory agency to allow it (Corporation A) the latitude to service *all* the needs of a given community because, due to economies of scale, it is able to service them better than if other companies were in there interfering with the operation. It is often mentioned that one might have to talk through several competing telephone companies' switching offices, for example, in order to call a neighbor across the street. The rights of exclusivity are usually granted the petitioner, since, in addition to the

legal horsepower, he is able to demonstrate many other such systems, in the same state or elsewhere, which are operating in a "satisfactory" manner.

Unfortunately, the satisfactory manner is determined not by the number of accolades from customers but from the lack of mail containing complaints: the logic seems to say that the null hypothesis is invalid because it is null. Should complaint-laden mail begin to appear at the offices of the regulatory agency, or the common-carrier itself (it is particularly effective to call a *corporate vice-president* of your telephone company if they have a service complaint—a *significant* amount of action will result), the administrative machinery of the common-carrier is called into play rather quickly and the "problem" is either solved post-haste or extensive correspondence (read: flak) is generated and placed in the regulatory agency's files regarding the complexities of the problem, past attempts to deal with such problems, the common-carrier's strained fiscal position, and the number of men and women working 'round the clock to service customers' woes. When tariff review time comes around, the carrier (which may be your natural gas, electricity, cable television, or telephone supplier) will roll out the big guns, point to all the memoranda it has filed with the regulatory agency, call in its corporate counsellors, and proceed to demonstrate, oh so rationally, that it cannot continue to progress without *some* fiscal remedies.

The most disenchanting fact, with which this article cannot purport to deal within its time-and-space frame but which has been mentioned often within these pages, concerns the lack of competition (*monopoly*). If, say, telephone companies were forced to deal competitively for the right to service each household (and thus required *by the customer* to provide high-quality service at the lowest rates), the incentive for profits might lead each such utility to make its operations more efficient and thus more cost-effective in a longer time frame. Few utilities, though, would desire to exchange the protective umbrella of their friendly state public utility commission for the harsh realities of the marketplace.

The legal monopoly afforded communications common-carriers by State regulatory agencies on intrastate matters and the FCC or ICC on interstate matters has made modern communications in many ways very *convenient* (not to be confused with *fair* or *cost-effective*). Telephone companies, the prime carriers of electromagnetic information, are naturally concerned with making money out of their ventures. Ma Bell has millions of miles of cable and loads of microwave facilities spread across this country, carrying information from one local telephone company to another via an administrative subsection called the Long-Lines Division. Should the companies at each (receiving or transmitting) end be a member of the Bell System, the telephone call you place from Florida to Oregon may be handled totally by equipment owned and serviced by AT&T or one of its subsidiaries. While this may be entirely satisfactory for a telephone conversation, the system is *not* prepared to meet the requirements of computer data communications through the same "dial-up" facilities.

There are limitations—very extreme ones in some cases—to the type and format of information which can be transmitted over the dial network. For example, *slow*-speed data transmission can be accomplished, with relatively few errors, over the dial network, such as two teletypewriters "talking" to each other. *High*-speed transmission, such as a computer network reservation service, is seldom accomplished as successfully over the dial network. Roughly, the transmission system difficults are analogous to a radio broadcasting system: Amplitude Modulation (AM) radio has a frequency response limited by ye old FCC to five thousand cycles per second (five kilohertz) and it sounds rather "tinny," especially when compared with the limitations of Frequency Modulation (FM) radio, whose frequency response is limited by the FCC to 15 kilohertz, which is aproximately the range of hearing for most adult humans. By contrast, television broadcasting eats up six megahertz for each channel (from two to 83), while your telephone conversations are limited by various local and interstate statutes and telephone company agreements to three kilohertz—about half of the frequency response of AM radio, and about five-hundredths of one percent of that available for television transmission. This frequency response, or bandwidth as it is often called, is the first critical factor in attempting to transmit data over telephone lines.

The second critical factor, and the one which causes the most severe problems, is that data transmission is, at the sending and receiving ends, a *digital* signal, sensitive only to the absence or presence of a pulse (and, to an extent, the magnitude or amplitude of the pulse), while telephone conversations are analog in nature, being a continuous variation in the frequency of a tone (your voice) and the amplitude of the tone (how loudly you speak). Nearly all data transmission systems using telephone company facilities utilize a device (called a modem) to convert digital pulses to analog waves for transmission over the line and a similar device to convert the analog signal back into digital pulses at the receiving end. Needless to say, significant possibilities for error in transmission are introduced.

These two problems, however severe, are capable of relatively straightforward technical solution. The third one, though, is what is really gumming up the works: when I call you on the telephone, we talk for two or three or perhaps 15 or 20 minutes; when one computer talks to another, they frequently tie up the system (i.e., the particular lines they are using) for stretches which are counted in hours, not minutes. This creates massive problems for a switching system which was designed and built for three-minute calls. The current problems in telephone communications between New York City and Chicago are representative of what can happen when customers decide that they want to transmit daily sales reports between the district office and the corporate headquarters over the dial network. The obvious solution, and one of those which was taken by the common-carriers involved, is to give the computer users lines of their own, charge them the appropriate fees, and let them talk to each other all they want, without messing up the dial network.

All well and good, until the consumers cried "foul" and accused the carriers of discrimination against telephone *and* computer users, by separating the rates (tariffs) chargeable to each. Coming to the rescue were a few entrepreneurs who decided that there was money to be made in providing computer users with a transmission system which did not (in their eyes) discriminate against the lengthy-transmission user and offered him better rates than could be put forth by the tele-

phone companies. This would have been fine, except that these private concerns sought to use (lease) telephone company facilities to aid in the transmission of their data. Until the "Carterfone decision" (permitting attachment of non-Bell equipment to Bell System lines) by the FCC in 1968, doing so was against the law. But by that time, the entrepreneurs had turned to another transmission medium, called microwave.

Microwave transmission consists essentially of setting up a network of hilltop-to-hilltop radio stations operating at frequencies above that of television channel 83, in portions of the radio spectrum which had been set aside for privately-owned microwave systems. The FCC could, within the statutes available before 1968, grant licenses to these stations without having to deal with the legal monopoly issue. The Commission has proceeded, albeit slowly, to deal with a plethora of such applications, culminating in their landmark decision of 25 May 1971, which ultimately will permit the establishment of nationwide hookups of point-to-point (customer-to-customer) data communications systems without the use of telephone company facilities.

That the facilities are now legal (according to the FCC) is not really a significant fact. The fact that AT&T is a bit disturbed about its loss of revenue is similarly realitively insignificant. The fact that, some day, two-way video transmission over cables (sometimes called two-way cable TV) and a terminal or access device into a computer may be available for every home which now houses a telephone is not overwhelmingly significant either. What *does* bear watching, listening, monitoring, and evaluation, is that (1) AT&T has come full circle historically and is competing in the sale of (essentially) telegraph lines again, after a major decision to proceed with voice transmission solely, and (2) virtually the entire communications industry is madly producing hardware to attach to these various networks without much regard to the future of communications and the inevitable **ROUND FOUR** but intent upon selling as many as they can as fast as they can, and (3) the federal government, that great regulator in the sky, seems to be in the business of stamping out fires rather than removing combustible influences—dealing with symptoms as they erupt rather than looking for the causes of these (and forthcoming, to be sure) disputes.

The basic problem lies in the nature of the FCC as a political entity. As such, it seems to respond to technological crises by invoking political and economic restraints—such as encouraging the single-source (monopoly) wire communications system of Ma Bell. Its recent move in favor of more competition more likely represents another pragmatic response to pressure groups than a fundamental change of principle. The Commission has an impossible job; it *cannot* police the thousands of licensees across the nation to ensure that they remain within the charters granted them. Lacking an overall conceptual framework, it *cannot* respond rationally to the technological advances which continually outpace and outscope the political and jurisdictional rules and regulations it sets forth. □

Michael Bloom is an electrical engineer and sociologist. He is a graduate of the University of California at Santa Barbara.

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Criminal loan sharking is a thriving black-market activity which contributes importantly to the operations of organized crime and hurts legitimate business in many ways. Most Americans know that loan sharking exists, but how, why, and in what ways it exists are mysteries to many people. These questions are analyzed from the economic standpoint for the first time in this article. The author describes the operation of supply and demand for loan-shark funds, showing what factors create a growing market for loan sharks, and examining the implications for society. Following this economic analysis, he looks at the public policy question: What should be done about loan sharking? He examines and rejects a number of possible approaches, then urges the establishment of open, legal competition with loan sharks.

For this article, Captain Seidl draws on an extensive study of criminal loan sharking which he made in the course of completing his doctoral dissertation at Harvard University. On active duty in the U.S. Air Force since 1961, he teaches courses in government and economics at the U.S. Military Academy at West Point. In the summer of 1969 he served with the Department of Community Affairs in the State of New Jersey. He was assigned to the John F. Kennedy School of Government at Harvard from 1965 to 1968.

let's compete with loan sharks

john m seidl

Sitting at a small, littered desk, Mark puffed on his cigarette. We were at his office, a new car agency in Philadelphia. Mark is a 32-year-old auto salesman, and his picture was prominently displayed across the room announcing to employees and customers alike that he had been the top salesman for the previous three months. He was talking about his experiences as a loan-shark borrower:

"You just don't understand what a good friend Jimmy [his loan shark] was. Let me give you an example. Just over a year ago—I guess it was about three days before Christmas—I was pretty well tanked up in one of our favorite hangouts in North Philly. It was around eleven or midnight. My luck wasn't running too well; I'd just bought the last round of drinks and was out of cash. I called Jimmy and told him I needed a couple hundred bucks to keep me going until the first. Thirty minutes later Jimmy arrived. He'd driven from South Philly through the snow that had been falling since early afternoon. He handed me $200 and left. Where else could I get that kind of service? I'd gladly pay extra for the couple hundred, wouldn't you?"

Mark's story highlights two key aspects of organized crime's activities—supplier service and consumer demand. Ironically, however, these aspects are seldom mentioned in discussions of organized crime. Most discussions are submerged in the moralistic fervor of "crime busting" experts. This fervor leads to hang-ups which seriously impair one's ability to analyze the phenomenon of organized crime in our society. For example, writers are often mesmerized by dramatic but irrelevant details which obscure the hard realities of organized crime. Some writers are fond of theories of national or international conspiracy, exotic names for criminal organizations and staff functions, ethnic membership requirements, ritualistic initiation ceremonies, nicknames for criminal entrepreneurs, and the character flaws of black-market consumers. Here are some samples from one prominent national magazine:

□ "Call it the Mob. The name fits, although any of a half-dozen others—the Outfit, the Syndicate, La Cosa Nostra, the Mafia—serves about as well. Whatever it's called, it exists, and the fact of its existence is a national disgrace."[1]

□ "The Mob is a fraternity of thugs, but it holds such power, wealth, and influence that in one way or another it poisons us all. It rigs elections and in so doing destroys the democratic process. More and more it is muscling into legitimate business—local, national, and international—to the extent that nearly every American is paying into its treasury in countless unsuspected ways."[2]

□ "The most shocking truth about organized crime in America is that all of us, one way or another, one time or another, pay tribute to the Mob. Out of ignorance, greed, easy tolerance, or fear we help it to grow fat with our money—whenever we deal with the Mob's businesses, its agents or those beholden to it: when a housewife buys the product of a Mob-controlled company; when a teenager feeds a Syndicate-owned jukebox; when a businessman negotiates a quick loan with a Mob userer; when a slum dweller plunks down 50 cents and hopes his lucky number will come up."[3]

What I propose to do in this article is to analyze one enterprise of "organized crime"—the loan-shark industry—from a different perspective. Using economic analysis, I will describe the industry and then attempt to answer the two central policy questions related to loan sharking: 1. What is it about loan sharking that offends [or pleases] society? 2. What policies and approaches might the United States adopt to deal with loan sharking, and which one would be most effective?

ANATOMY OF AN INDUSTRY

At the outset, let us define our key term. Criminal loan sharking can be identified by the following essential characteristics:

□ Cash is lent at very high interest rates—generally 20 to 100 times higher than rates charged by legitimate lending institutions.

□ The borrower-lender agreement rests on the borrower's willingness to pledge the physical well-being of him and his family as collateral against a loan. The corollary of the borrower's willingness is the lender's willingness to accept such collateral, with its obvious implications for what he *may* have to do to collect.

□ The borrower believes the lender has connections with ruthless criminal organizations. That fact and his expected need for future loans induce him to repay.

Our definition of criminal loan sharking raises a useful question: What is illegal about a loan-shark transaction? The laws most often violated in loan-shark transactions are state usury laws. It is the lender and not the borrower who acts illegally. Violation of these laws is almost always punishable as a misdemeanor. The loan shark may violate the law in two other ways: he may be prosecuted for conducting a loan business without a license or proper authority; or, if he explicitly uses the threat of force or violence to make collections, he may be prosecuted for extortion. Two states have passed special criminal usury statutes in an attempt to make loan sharking itself a serious offense. In Illinois and New York it is now a felony to lend money at interest rates in excess of 20% and 25% per year respectively.

SOURCE OF FUNDS

Large-scale criminal organizations provide most loan-shark funds. These organizations derive the biggest share of their profits from exploiting the black market in goods and services created by the legislation of moral standards of conduct. But while they thus may be involved in gambling, narcotics, loan sharking, racketeering, and fencing stolen property, they may engage in legitimate business as well.

Loans from legitimate lending institutions direct to loan-shark borrowers provide a second source of funds. This type of lending does not depend on thoroughly corrupted lending institutions but merely on one or two loan officials who flaunt company regulations for sizable kickbacks from loan-shark organizations. This is how it works:

Loans supplied to borrowers by legitimate lending institutions are first negotiated by the loan shark and his customer. A lump-sum charge for the service of securing the institution's money is agreed to by the borrower. The borrower then may sign a note payable to the loan shark for the total amount of the transaction—usable principal plus charge. Or he offers the loan shark worthless or fraudulent collateral equal to the amount of the transaction. In either case, the collateral or the note is given to a specific loan official and discounted; the proceeds are then paid directly to the borrower. The borrower, in turn, pays the lump-sum charge "off the top" to the loan shark, and repays the total amount plus *normal* interest to the lending institution.

INTEREST RATES

The interest paid for loan-shark funds is at traditional rates which have been established over time.

There is a small-loan rate which is charged by sharks who work industrial plants, docks, construction sites, and neighborhoods catering to blue-collar and lower-middle class borrowers. Individual loans ranging from $50 to $1,000 are common, and the average loan is probably somewhere between $150 and $400. Borrowers use the money for a wide variety of purposes ranging from the paying of gambling debts to the buying of household necessities.

The street corner loan-shark racket of the 1920's and 1930's was known as the "six for five" racket. "Six for five" means that the interest on a $5 loan for one week is $1. Thus if the borrower repays the principal and interest in one week, he hands back $6. If he does not desire to repay the principal, he pays weekly interest which is $1 or 20% per week. That rate continues to be widely accepted for small loans. It is equivalent to 1,040% per year. The interest charges—called "vig," "vigorish," or "juice"— are due each week as long as the principal is outstanding. The principal can be reduced only in lump-sum, or in some cases, half-lump-sum payments.

In some urban areas, the rate is 20% for a six- or ten-week period, with interest charges added to the principal and the total repaid in equal weekly installments. For example, 20% for six weeks means that a $200 loan costs $240 and is repaid in six weekly installments of $40 each. The borrower receives full use of the total principal for only one week, and the amount of principal available to him decreases each week as he makes a payment. The 20% add-on interest rate for a six-or ten-week period is equivalent to 200% to 350% per year.

There is also a large-loan market. Large-loan customers differ in educational and occupational backgrounds from small-loan borrowers, and they usually deal with a higher echelon of the loan-shark industry. Little can be said about the general characteristics of large-loan borrowers, except that they appear to fall into three categories with three different types of credit needs: 1. Smaller-company businessmen who need *working capital*. 2. Speculators,

promoters, and producers who need *venture capital*. 3. Individuals who need *personal funds* to satisfy spending habits or cover illegal business activities.

Loan sharks who lend to large-loan borrowers are capable of making loans from a few hundred dollars to more than $50,000. The standard rate for these loans is 5% per week or approximately 250% per year. There is no installment lending in the large-loan business, and principal reduction is usually negotiated by the borrower and lender.

COLLECTION PROCESS

A loan-shark organization's reputation for violence and ruthlessness is the most important factor inducing borrowers to repay their loans. The lender may convey that reputation by his physique, appearance, temperament, outlook, willingness to carry arms, and connections with criminal organizations, whether real or imagined. In addition, the borrower's perception of the loan-shark industry hinges on his previous contacts with the underworld and his exposure, *through communications media*, to criminal organizations and their enforcement methods. A formidable industry reputation makes the individual loan-shark's job easy by removing many of his potential collection problems.

Actual violence is minimized. Fear and anxiety about it are used instead to motivate delinquent borrowers. Actual violence is likely to be counter-productive from an organization standpoint, for it may bring increased scrutiny of loan-shark activities by public, law enforcement, or underworld elements. In addition, it hampers lending profitability. It makes repayment more difficult for the individual who is victimized and discourages new or continued borrowing by making customers more apprehensive.

DEMAND FOR LOAN-SHARK FUNDS

The keystone of the loan-shark industry is borrower demand. Without it, the industry could not exist. This is because the combination of funds and services provided by loan-shark organizations is not available in the "upperworld." Two factors account for this unavailability:

1. *Usury laws*—By placing a legal constraint on interest rates, usury laws limit the risk-taking ability of lending institutions generally, and more particularly during periods of tight money. Consequently, individuals and firms that desire high-risk loans and are willing to pay something equivalent to a free market price for them, are denied opportunities to borrow in the upperworld. Thus they become potential prospects for the black market.

The role of usury laws in creating a black market for criminal loan-shark organizations is not a unique phenomenon. Whenever a commodity or service is declared illegal, the law automatically provides "protection" to those who desire to supply that service or commodity and who are willing and able to operate illegally. The law creates the necessary conditions for criminal monopoly by destroying legitimate competition. For example, this is clearly what happened with the passage in 1919 of the Eighteenth Amendment prohibiting liquor sales.

2. *Traditional lending practices*—Upperworld lending practices, which are partly dependent on usury laws, also shape demand. For one thing, the procedures for transacting loans are unduly formal and involved when compared with loan-shark lending services. In the case of the latter, secrecy, informality, speed, convenience, and availability are characteristics that attract borrowers. No one needs to know about the loan, including the borrower's family, neighbors, employers, or creditors. The borrower need not wait, subject himself to interview by stuffy loan officials, or fill out long, complicated forms which are particularly embarrassing for individuals without language facility. Customers who have successfully borrowed from loan sharks can secure successive loans just as quickly as they can contact their shark. Hours of operation are not a problem; loan sharks lend money every day and night of the week.

Such service simply is not available from upperworld lending bureaucracies. If it were, the market for criminal loan sharking would not be nearly so big.

In addition, high-risk capital simply is not always available from traditional lending institutions; some borrowers are *forced* to seek such funds from loan-shark organizations. The crux of the problem is that banks and finance companies consider interest rates only within a narrow range. Strict risk standards are developed for this range, and borrowers are accepted or rejected according to whether they can meet these standards. Cyclical economic fluctuations do not appreciably alter the credit selection processes. In fact, tight-money periods work to the advantage of creditors by allowing them to be more selective in accepting borrowers. The fluctuating interest rate reflects the dynamics of the scarcity and abundance of money much more than it reflects varying repayment risks facing lenders.

To illustrate the impact of the factors just described, let me refer to the case of a small businessman whom I shall call Harold. He runs an antique shop which is located in the center of downtown Philadelphia. In a talk with me he explained his borrowing from loan sharks this way:

"Look, in my business I need a continuing line of credit. When I hear or read about a sale or an attic filled with 'junk,' I want to take off right away with the necessary cash to make the purchase if the stuff pans out. I went to a number of the Philly banks trying to get a line of credit. Everyone put me off. They said they couldn't evaluate my inventory. They were all ready to lend me $10,000 with a regular payback, but that's not what I need. My buying is too lumpy. One day I met Ed. He offered me $2,000 in a pinch—no questions asked. From then on I did business with him. Whenever I heard about a sale I wanted to attend, I called Ed. I'd meet him at Fifteenth and Chestnut. He'd show within 30 minutes if I was in a rush. The transaction was simple. Ed would hand me an envelope, and I'd be on my way. I seldom even checked the contents; I could trust Ed always to give me what I asked for."

One might argue that the nonavailability of high-risk loans is strictly a function of usury laws. Many states permit any specified interest rate agreed to by two parties bargaining for consideration. In other states, usury laws do not apply to borrowing by corporations. In these cases, it is not usury laws but lending practices which exclude the making of high-risk loans, especially to small businesses.

HOW BIG IS THE MARKET?

It is almost impossible to assess the extent of the loan-shark market except to say that it is large and growing larger. A few statistics do exist which allow one to speculate about a potential loan-shark market, but many assumptions about their relevancy and borrower behavior must be made before the data are at all useful. [4] For example:

A study of five large- and medium-size consumer finance companies from 1957 through 1964 showed that these companies rejected slightly more than 50% of all new loan applications. These rejected applicants—about 12.5 million people in 1958—form a part of the potential *small*-loan market. [5]

Certainly not all or most of these rejected borrowers would be likely to turn to loan sharks, but the figures do give an indication of the large number of borrowers who fail to secure consumer loans in the upperworld.

Trying to get an estimate of the size of the *large*-loan market is even more difficult. There are few useful statistics in this regard. An example of the extent of the market can be surmised from the fact that between 30 and 45 large-loan organizations operate in New York City alone. For the country as a whole, there are hundreds of such lenders. While the number of large-loan borrowers rejected by legitimate lending institutions must be far less than the number of small-loan rejects, there still must be a bountiful list of prospects here for loan sharks.

ECONOMIC ANALYSIS

Evaluating costs and benefits from criminal loan sharking is a difficult task because of limited data, incommensurables, and uncertainty. It is impossible to consider all costs and benefits in terms of a common denominator—for example, dollars. How does one assign a dollar cost to the role of loan sharking in maintaining large-scale criminal organizations that corrupt or undermine government, as appears to be the case in New Jersey? Or how does one assign a dollar cost to the degradation of family morale and solidarity that results from the threat of violence in loan sharking?

Nevertheless, economic analysis is helpful for two reasons. It provides an orderly, comprehensive presentation of the important considerations in loan sharking in a manner that forces one to consider trade-offs and alternatives. Further, it helps us distinguish different costs and benefits and thus make better judgments about policies and programs.

OFFENSIVE ASPECTS

Now that we have an understanding of the nature of supplier service and consumer demand in the loan-shark industry, let us attempt to answer the first of the two key policy questions raised earlier. What is it about loan sharking that offends [or pleases] society?

We should first attempt to answer this question in terms of what "the law" itself does not like about loan sharking? The answer is not clear. Loan-shark transactions are crimes without victims; the borrower merely purchases a black-market service, although inherent in that purchase is the risk of victimization should he become a delinquent borrower. But, more importantly, the borrower is purchasing a service to which no sin is attached. Therefore, this case is different from most other black-market services. The outlawing of gambling, prostitution, and narcotics is aimed at denying the consumer the satisfaction of wants considered immoral or antisocial.

Usury laws, on the other hand, exist to protect the borrower in a lending transaction where it is believed that he possesses unequal bargaining power vis-a-vis the lender. Thus usury laws are analogous to fences around swimming pools, locks on medicine cabinets to keep children from poisoning themselves, laws regulating the disposal of wornout refrigerators, and food and drug laws enacted to protect consumers.

In loan sharking, however, there is often no "victim" to protect. Why, then, is it generally thought of as a victimization process? Probably one reason is that the law only becomes formally aware of those loan-shark transactions which do involve victimization. Also, the loan-shark industry is operated and controlled by large-scale criminal organizations. If loan sharks secured their funds from legitimate organizations, such as The Ford Foundation, and if the money were clean and the entrepreneurs not intimately connected with the underworld, maybe the law would not be so concerned with the problem of loan-sharking. Perhaps, too, high-risk lending itself would not be considered so bad.

HAZARDS TO SOCIETY

From the standpoint of social norms and values, what is offensive about the loan-shark industry?

1. *We do not like a lending system that rests on the threat of violence.* Even though actual violence is seldom used to induce repayment, the threat of violence affects the morale, welfare, and solidarity of selected individuals and families by restraining their freedom of action and impairing their mental and physical capabilities. Note that this is not an evil inherent in high-risk lending, but an evil that stems from the nature of those who control it.

2. *We do not like a high-risk lending system that is a criminal monopoly.* It results in excessively high interest rates, since criminal entrepreneurs are "protected" from competition by usury laws and traditional lending practices. Moreover, loan sharking provides a basic organizational incentive for large-scale criminal organizations, and we do not like nor should we tolerate these types of organizations. They pose a threat to local pluralism because they are accountable to no one in the upperworld; they evade large tax bills; they create incentives which result in increased levels of predatory crime; and they undermine social morale and public morality because of their continual violation of the law. Note that, again, these are not evils of high-risk lending per se.

3. *We do not like the corruption which buys "protection" for the loan-shark industry and its related activities.* Corruption results from the fact that loan sharking is illegal. Presumably, we increase the probability of corruption whenever a transaction is made illegal or is taxed to the point that it is profitable (even after paying off public and law enforcement officials) to evade taxes.

4. *We do not like a lending system in which borrowers can easily accept more debt than they ought to.* This evil is probably inherent in any high-risk lending system. The real question is: To what extent should the state view its role as a paternalistic protector of certain individuals who have a propensity to borrow beyond their means?

Since we are not paternalistic with regard to consumer expenditures or consumer borrowing for such items as television sets and automobiles, it does not seem necessary to be especially worried about high-risk borrowers. In addition, if we are faced with a problem of individuals borrowing beyond their means, we would probably prefer that they do so from legitimate institutions that make their records public, not from criminal organizations that are shrouded in secrecy.

Having considered what it is about loan

sharking that offends society, let us turn to the question: What aspects of the loan-shark industry do we desire to preserve? We want to preserve a high-risk lending system which is *responsive* to borrowers with legitimate needs for high-risk loans. To accomplish this, the lending service presently offered by the loan-shark industry must be duplicated by legitimate lenders. This point is crucial.

PROPOSED EXPERIMENT

We have seen that society suffers a number of undesirable costs as a result of criminal loan sharking. But we have also seen that underworld lending meets a need felt by many people. Let us keep in mind that there are trade-offs to consider between costs and benefits when we study different possible ways of dealing with loan sharking. Let me review briefly several options that I do not think are desirable.

The most obvious one is to do nothing more than is being done about the loan-shark industry. Some people may believe that present policies suppress enough—or perhaps too much. Increased effort may be considered unjustified in view of the costs required, the expected gains, and the opportunity costs for added expenditures. Also, there may be some who believe that we do not know enough about loan sharking to choose a new policy approach. They might elect to do nothing more until further research demonstrates a greater need to implement new policies and shows more clearly what should be done.

To other people, the loan-shark industry is the most effective institution for accomplishing high-risk lending. This belief could stem from the conviction that the threat of violence is essential to profitable high-risk lending. A second policy option, therefore, is to increase consumer awareness of loan-shark services and attempt to lower loan-shark prices. This is not an amoral choice of action if it is assumed that recognition of the activities of loan sharks might make society privy to more of their operations and reduce some of the uncertainties involved.

Such a policy might also appeal to those people who believe that loan-shark borrowing is an equitable mixture of service and punishment for persons who cannot manage their financial affairs within the reasonable constraints of upperworld lending. The trouble with this approach is that it leaves the industry in the hands of undesirable characters.

A third option is to attack the loan-shark industry and its attendant consequences with more efficient and effective law enforcement techniques. This means, in effect, that the legal tools of arrest, indictment, prosecution, conviction, and sentencing should be made more effective.

However, a legal strategy does not effectively attack the fundamental causes of the black market-usury laws and traditional lending practices. It does not establish an alternative method of high-risk lending but merely attempts to provide a continuous antidote for the illegal activities which are caused by the black market. Police bureaucracies cannot be expected to wage all-out war on the loan-shark industry because political and social pressures demand much more from them than attending to this problem.

Thus this option would perpetuate the economic incentives to maintain criminal organizations and to exploit the black market in loans. There would still be incentives to corrupt public officials. And there would likely be continued violation of the law with its detrimental effects on social morale and public morality.

RESTRUCTURING THE MARKET

I want to propose another approach, an economic strategy that has received little public discussion. The strategy is to restructure the black market in loans. It means promoting a new high-risk lending system in the hope of preserving some features of loan sharking that borrowers like while discouraging the offensive aspects. Implicit in such an economic strategy is the elimination of usury laws and a loosening of traditional lending practices.

The aim of the strategy is to attack the organizational incentives of the loan-shark industry. It is not directed at particular individuals but at the economic motivations which support criminal loan sharking. It assumes that we would prefer to see a prospective borrower get his loan at a high rate than not get a loan at all. Moreover, it seems reasonable to expect that high-risk lending rates would come down (while other rates might go up a little) if usury laws were eliminated and if legitimate lenders were encouraged to compete with the criminal loan sharks.

In addition, if we desire to fight criminal loan sharking because it fosters corruption and disrespect for the law, we probably can best eliminate these evils by legitimatizing high-risk lending. As pointed out earlier, these evils are not inherent in all high-risk lending; they occur when it becomes well organized outside the law. If we view corrupted public officials as individuals who "sell" licenses to loan-shark organizations for a profit, we could deny them this franchising capability by legalizing high-risk lending.

Also, an economic strategy would have a built-in feedback system—i.e., the market mechanism. Providing legitimate high-risk loans means that a portion of the presently illegal black market would be revealed for public scrutiny and data collection; the existing shroud of secrecy would be less pervasive. Thus supply and demand data would be easier to collect, and legitimate lending policies could be revised and improved as market developments occur.

What about the dollar costs of such an economic strategy? Owing to much uncertainty, especially in the area of default rates, it seems feasible for government to initiate the restructuring of loan-shark markets and to absorb the initial short-run costs either through direct participation or subsidy. The ultimate aim, however, should be a profitable, high-risk lending industry which is privately owned.

A long-term goal may be the licensing and regulation of high-risk lending firms or perhaps the establishment of what is called judicial restraint for borrowers or lenders who complain they have been treated unfairly. [The British system of regulating interest rates is judicial restraint. No statutory maximum interest rate exists for any loan. Courts can declare any transaction usurious and decree a reasonable arrangement for the parties concerned. British statute reads that interest in excess of 40% per year will be presumed to be excessive unless proved otherwise. Thus freedom of contract subject to good faith and fair dealing is the British approach to interest regulations.) [6]

An essential element in an economic strategy is the design of the new lending service. This will determine whether new firms can compete with criminal loan sharks. Public or private firms could be the experimental lenders. In fact, there may be an advantage to having both types of lenders in an initial program. [My hunch is that public firms would be less effective because of stricter accountability requirements and more formal bureaucratic rules.]

Legitimate firms, whether public or private, will be at a competitive disadvantage, however, because they will not be able to accept a borrower's body as collateral, nor can they resort to the collection techniques of criminal loan sharks. Some

might urge the reestablishment of debtor's prison or flogging, but these methods are impractical and undesirable. Bear in mind, though, that legitimate firms do have a potential competitive advantage. They can eliminate much of the risk that exists for loan-shark borrowers. The key is to duplicate the service elements in loan-shark transactions while eliminating the threat of physical violence in the collection process.

Secrecy, informality, speed, convenience, and availability must be incorporated in the new lending service, and many traditional lending practices must be put aside. The lender must rely on the borrower's needs for future loans to secure repayment, not on conventional credit criteria. Whether these needs will be a sufficient incentive is a question that can be answered only after experimenting with my proposal. But what is clear is that legitimate lenders cannot compete effectively in this business unless they can duplicate at least some of the service attractions provided by underworld lenders.

IS THE PROPOSAL WORKABLE?

Is an economic strategy politically feasible? An objective analysis of the costs and benefits to society from the loan-shark industry is improbable among legislators at any level of government. The repeal of usury laws is not likely to receive support from consumer groups, financial institutions, or legislatures. Certainly a legislative strategy would be more acceptable to these groups, especially the legislators who, for the most part, are legalists themselves. Such considerations seem to condemn an economic strategy to an intellectual limbo. But there is a way to circumvent the problem. This is to sell a legislative body on a temporary strategy for a specifically defined area, and then expand the program bit by bit *if results warrant it*.

If it practical to try to establish legitimate high-risk lending firms? Departure from traditional lending practices will be difficult to accomplish. Bureaucratic changes of this type in the financial community will be slow, painful, and tedious. Perhaps the best approach is to create new lending services through, say, innovations in credit card usage or looser instant check credit; they might also be developed by giving lending officials vans and weekly routes through different neighborhoods and industrial areas, thus taking them out of the traditional institutional environment and into that of prospective borrowers.

Another possible pitfall is that legitimate high-risk lending which incorporates secrecy, informality, speed, convenience, and availability may create attractive incentives for loan officials to make good "bad" loans. If a lending institution is willing to accept the higher default rates inherent in high-risk lending, it may be unable to keep loan officials from giving away their funds for sizable kickbacks. The underworld eliminates this potential problem with its rigid discipline. But legitimate lending institutions would not be free to use the threat of violence against employees who break the rules.

Nevertheless, I feel that it is possible to overcome this problem by careful selection of loan officials, payment of high salaries, and establishment of reasonable bookkeeping checks. Only an actual experiment, however, can prove or disprove this belief.

We could not hope to entice *all* loan-shark customers to borrow from legitimate lenders if competing high-risk lending institutions were established. Our factual data do not support such a cavalier notion. What we can hope is to destroy a portion of the loan-shark black market, and to significantly reduce the economic incentives which give rise to profitable underworld money lending. To restructure the loan-shark market is to attack large-scale criminal organizations. But since we do not know how these organizations will react, how are we positive that legitimate high-risk lending is feasible. Limited restructuring is the most practical way to begin.

It is important to establish feedback procedures so that upperworld lenders can adjust to the competitive tactics of criminal loan sharks and their parent organizations. Administrative procedures must provide for continual reassessment of policy aims in the light of underworld reactions to competition. In addition, surveys of borrower attitudes could help the new lending agencies to adapt to market demands.

CONCLUSION

We should try to compete with underworld loan sharks by establishing legitimate lending institutions, beginning in an experimental way in some specific area. Such an approach would allow for the testing of our assumptions and ideas about loan sharking and the general aspects of black-market crime. It would enable us to determine, with a minimum of risk, whether legitimate lending institutions can be designed to compete favorably with loan-shark organizations, and, if so, how.

It would help to answer other questions as well. Can these institutions operate on a profitable basis without government subsidy? If required, what level of subsidy is needed? How does lending competition affect the incentive structures of loan-shark organizations and large-scale criminal organizations? What adjustments will be made in the underworld if we restructure loan-shark markets in the manner described?

More generally, an experiment in competition should provide data for future policy decisions related to all types of consensual crime. For instance, is the restructuring of markets a feasible and effective strategy for combating other forms of black-market crime—especially, gambling and prostitution? If competition with loan sharks results in sizable losses for underworld organizations, the next step should be competition in gambling—one of their basic money-makers. But we are getting ahead of ourselves; what is needed now is an attempt to compete with loan sharks. □

NOTES AND REFERENCES

[1] "The Mob," *LIFE*, 1 September 1967, p. 15.

[2] Ibid.

[3] "The Mob," *Life*, 8 September 1967, p. 91.

[4] For a more detailed discussion of the extortionate loan-shark market see my paper, Report to the President—A Study of the Loan-Shark Industry, Department of Justice, Law Enforcement Assistance Administration, pp. 138-57.

[5] John Chapman, "Role of Consumer Finance Companies in a Credit Economy," in *THE CONSUMER FINANCE INDUSTRY: ITS COSTS AND REGULATION*, edited by John Chapman and Robert Shay (New York, Columbia University Press, 1967), p. 22.

[6] See Raymond M. Conner, "Usury—An Analysis of Usury Legislation and the Mississippi Corporate Exception Statute," *MISSISSIPPI LAW JOURNAL*, March 1967, p. 347.

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free enterprise and the monopoly myth

rod manis

It is a widely accepted myth that free enterprise leads to monopoly or the control of industry by a few and that the government must intervene to protect consumers. Even strong supporters of capitalism have been taken in. But, to the contrary, (1) there is no movement toward concentration; (2) such a movement could never happen; (3) no harm comes from the private ownership of an industry even by one or a few; (4) even if there were harm, the government is incapable of alleviating it; (5) government actions themselves create harmful monopolies and cartels.

A *monopoly* is a firm protected from competition by force. A *cartel* is two or more firms so protected. Since the private use of force to drive out competitors is usually prohibited (except for labor unions), governments are responsible for most monopolies and cartels. These are the traditional and most useful definitions.

Many people today, however, give these labels to one or a few firms that dominate an industry. If they maintain their position without using coercion, they are simply single sellers or (if a few act together) group sellers, respectively. [1]

Several studies have been made to determine if industry is becoming more and more concentrated and their results strongly indicate that the relative concentration of ownership has remained virtually the same since the turn of the century (when the earliest study begins). [2]

People often mistake the increasing size of business with concentration because they forget that the size of the market is growing too. Several forces work to increase competition. Cheaper transportation gives consumers greater choice. The rapidly growing franchise businesses (like pick-up food venders and service stations) give opportunities to those with little capital who want to start their own businesses.

CONCENTRATION

While some industries attract attention when they become more concentrated (autos), industries that are becoming more diversified are overlooked. When U.S. Steel was organized in 1901, it produced two-thirds of America's steel ingots. By 1925 it held only 42% of the market and holds about one-third today. [3] Likewise, Rockefeller's Standard Oil company refined 80-90% of American oil in the 1890s but only 44% in 1912 when it was convicted of "monopolizing." None of these markets losses can be attributed to the Sherman Antitrust Act because prosecutions were rare in those days. These and many other such experiences should dispel the illusion that a large firm doesn't face competition or cannot lose its market position.

A very large obstacle to concentration is the immense difficulty of managing large organizations. The problems of bureaucracy, information, control, decision making, red tape, etc. quickly raise the costs of firms that expand too far. General Motors found many years ago that it had to decentralize in order to remain efficient. Most decisions are now made on the plant level with the central office making only broad decisions and raising capital. Thus, the different plants and divisions of General Motors virtually compete in the market as if they were separately owned.

TRUSTS

The Democratic Party Platform of 1888 called tariffs and quotas the "mother of monopoly." The famous trusts of the time (e.g., sugar and tobacco) were protected from foreign competition. It was wisely argued that free trade would protect the American consumer by allowing the whole world to compete for his business. Monopolizing the world production of a product is infinitely more difficult than monopolizing a national market. When Brazil tried to restrict her coffee sales to raise prices, she only succeeded in causing coffee to be grown in other countries, which meant greater production and *lower* prices than before.

It is also commonly believed that a firm can lower its prices below costs, drive out its competitors, and then raise its prices above the old competitive price and make up its losses and more. But such actions cannot and do not take place. [4] No firm could profit from such action. If it wanted to be the sole or major seller, there is a better way of doing it.

COMPETITORS

If a firm cut its price below its cost, it would be giving away wealth and taking a loss. The larger its share of the market the greater would be its loss. Meanwhile, its competitors could cut their losses to a minimum. In effect, the demand for their product will be reduced but not indefinitely. To argue that they would be permanently driven from the market is to ignore the fact that every business faces a fall in demand at some time. For example, the demand for Christmas trees is zero for most of the year. Yet every year we find sellers as Christmas approaches. Wars occur sporadically and usually without warning, yet pro-

ducers seeking contracts swarm government procurement offices whenever the demand is restored for war materials.

Most firms will either shut down (to reopen later) or produce for inventory (to be sold when our aspiring single seller quits his foolishness). They might even buy the cheap product for their own inventory to be sold later.

If you were to invest in either company, you would naturally bet on the competitors who are sustaining the smallest loss, certainly not on the one that is suffering the greatest loss and is thus bound to lose the struggle. Even if it began as a wealthy company, wise investors and creditors will withdraw their money and put it with the sure winners—the competitors. [5] In short, you cannot threaten anyone by promising to inflict more damage upon yourself than upon them.

Even if you force them (competitors) to close temporarily, they would always be back when you tried to raise the price above the competitive level. If starting up again required a lot of capital and they feared you might lower your prices again, all they need do is go to your customers, whom you are now overcharging, and get a contract to supply their needs at the competitive price, build a plant, or reopen an old one. They need have no fear of you and, what is more, you may lose all of your business.

If you *want* to be a sole producer, there is a much easier and cheaper way to do it. Simply buy out or merge with your competitors. Of course, if you raise your price above the competitive lev el, you will simply find new competitors appearing, as they always appear when demand is present. Again, they can protect themselves for long run production by getting contracts even before they open.

PRICING

Suppose, however, a firm were more efficient than its competitors (could produce at a lower cost) because of some special management, patent, labor, land resources, organization, innovation, etc. It could then either sell at the competitive price and make a pure profit, or slightly below the competitive price (the lowest cost of its competitors) and expand to produce for the whole market while forcing out its competitors. It could not charge *above the old price* without competitors coming in (by using contracts, if necessary, as before). It could charge near the competitive price and get the pure profit (which in the long run would go to the owner of the resource that gives the special advantage). This serves as an incentive in the economy to innovate, discover, become efficient, etc.

You might also practice price discrimination, i.e., sell to some of your customers at the competitive price and others at lower prices down to the lowest cost of producing an additional unit. This practice will not only bring you the most profits but is economically efficient, as resources will go to their highest valued use. [6]

Those who value the product most will pay the highest price and those who value it less will pay less. Some may not "like" it, but they will all pay as much or less than the value they receive, thus they will all be better off. Also, the right amount of product will be produced.

There may be two obstacles to price discrimination. First, those who pay the lower price may resell to those who must otherwise pay the higher price. To avoid this possibility, you need only require buyers to sign a contract not to resell. Courts should enforce such contracts.

Second, discovering or administering the right prices to the right people may cost more than the increase in revenue. Under such circumstances the single efficient seller may simply charge the higher, competitive price to everyone and restrict the output. Such would be inefficient only if there were a cheaper alternative.

In this case, it is usually argued that government should step in with either price or rate controls or antitrust legislation. [7] It is quite unlikely, however, that these policies, even in theory, would do more than increase the waste.

REGULATION?

To try to make the company produce at the lowest cost and output *as if* it had equally efficient competitors encounters the classic problems of price regulation. [8] First, what price and what quantity? No two economists or accountants or regulators will agree (even in principle, not to mention after sorting through the books and figures of the company!). If the firm is directed to produce at the lowest cost)as determined by the regulators), the firm's owners will simply take their profits increasingly from the expenses of the firm (fine offices, company cars, pretty secretaries, etc.). With costs now up, they will apply for and invariably obtain permission to raise their rates. It would have been better to have given them their profits in cash and let them buy what they want.

Also, if this is the way innovation is rewarded, it will be stifled. Thus, price regulation offers us no hope of improvement but almost a guarantee of greater loss.

The same is true for antitrust laws. At best they can keep the efficient firm from expanding, thus perpetuating the old price and output which was the worst of the free market solutions. What is more likely, it will prevent an efficient firm from expanding, lowering prices, and increasing output in the long run, thus thwarting progress and improved standards of living. This is, in fact, what U.S. antitrust laws have come to do. [9]

GOVERNMENT "HELP"

Whereas the emergence of harmful or wasteful single sellers in a free enterprise economy is not possible, government imposes a host of harmful monopolies and cartels on the American people. [10- The Postal Service, much of our educational system, public and private utilities, taxis in major cities, etc. are largely monopolies. The FCC, ICC, CAB, and FPC enforce cartels upon the communications, transportation, airline, and utility industries [11]. Government helps farmers, unions, doctors, lawyers, and some businesses to organize to exclude competition, raise prices, and restrict output [12]. All of these create waste because (1) efficient firms and resources are kept away from their highest valued use and (2) price discrimination is usually disallowed, preventing efficient solutions.

If one agrees with any one of the six points (listed in the beginning), he will have to conclude that (free) enterprise should be left along and that our desire to end monopolies and their evils should be directed at ending the government regulations that create them. □

NOTES AND REFERENCES

[1] Alchian, Armen A. and Allen, William R. *UNIVERSITY ECONOMICS* (Belmont, California: Wadsworth Publishing Co., Inc., rev. 1967), pp. 320-22, point out some of the difficulties of getting a group of sellers together to agree on prices and quantity. (1) It is difficult to determine one's competitors because of the many substitutes facing all products. (2) It is

difficult to get agreement among sellers. (3) There are "gains from secret cheating." (4) " . . . Not all competitors (actual or potential) can be induced to join: excluded firms are delighted . . . " to get more business. (5) "If expensive facilities are involved, the colluders will suffer a loss of their own large investment if new entrants do appear—an effect that will continue after the effectiveness of the collusion has ended."

[2] Telser, L. G., "Cutthroat Competition and the Long Purse," *JOURNAL OF LAW & ECONOMICS* IX (October 1966), pp. 276-77. "No one who examines concentration data can fail to be impressed by the stability of the concentration ratios from industries, the average industry concentration ratio was 44.1 per cent in 1947 and 43.6 per cent in 1958."

[3] Stigler, George J. "The Dominant Firm and the Inverted Umbrella," *JOURNAL OF LAW & ECONOMICS* VIII (October 1965), pp. 167-71.

[4] McGee, John S., "Predatory Price Cutting: The Standard Oil (N.J.) Case," *JOURNAL OF LAW AND ECONOMICS* I (1958), pp. 137-68. McGee found "little or no evidence" to support the widely accepted account of the systematic use of predatory price discrimination by the Standard Oil Co. of New Jersey. Any serious student of the subject should read McGee's entire article.

Brozen, Yale, "Competition, Efficiency, and Antitrust Compatibilities and Inconsistencies: An Economist's View," delivered at the National Industrial Conference Board's Eighth Antitrust Conference, New York, 6 March 1969. "Open entry may be a sufficient condition for competition and enforcement of efficiency. The meaning of entry has been confused by considering only the appearance of a new contender in the market as entry and failing to consider that any expansion of capacity from whatever source is entry."

[5] Gerber, Albert B. *THE BASHFUL BILLIONAIRE* (New York: Dell, 1967), pp. 228-54. The very wealthy Howard Hughes (about $2 billion), despite determination and every possible legal and financial maneuver, lost control of TWA to his creditors though he still owned over 75 per cent of its stock. This shows the weakness of private wealth against competitive financial institutions such as banks, investment houses, and insurance companies. Hughes wasn't running TWA profitably so they squeezed him out.

[6] *UNIVERSITY ECONOMICS*, p. 331, f. 13.

[7] *IBID.*, pp. 324-26. "The case against effective collusion comes down to the same point raised in connection with price-searchers' markets—'inefficiency' in the allocation of resource uses. Granted for the sake of argument that there is a misdirection of resources, a proposal to prevent voluntary pooling of private wealth is denial of private-property rights. The criterion of 'misdirected' or inefficient use of resources is itself dependent on the normative premise that individuals should have the right to make choices about use of goods. If we accept a criterion of efficiency relying on open market revelation of values we cannot logically deny fully contracting rights to achieve efficiency meaningful only for private-property rights. Yet that is what a refusal to allow mergers amounts to."

[8] Stiger, George J. and Friedland, Clair, "What Can Regulators Regulate? The Case of Electricity," *JOURNAL OF LAW & ECONOMICS* V (October 1962), pp. 11-12. "The ineffectiveness of regulation lies in two circumstances. The first circumstance is that the individual utility system is not possessed of any large amount of long run monopoly power. It faces the competition of other energy sources in a large proportion of its product's uses, and it faces the competition of other utility systems, to which in the long run its industrial (and hence many of its domestic) users may move.

"The second circumstance is that the regulatory body is incapable of forcing the utility to operate at a specified combination of output, price, and cost. . . . Let us assume that the commission would set a price equal to the average cost . . . then the utility can reduce costs . . . by reducing one or more dimensions of the services which are really part of its output: peak load capacity, constancy of current, promptness of repairs, speed of installation of service. It can also manipulate its average price by suitable changes in the complex rate structure (also with effects on costs). See Demsetz, Harold, "Why Regulate Utilities?" *JOURNAL OF LAW & ECONOMICS* XI (April 1968), pp. 55-65. "In the case of utility industries, resort to the rivalry of the market place would relieve companies of the discomforts of commission regulation. But it would also relieve them of the comfort of legally protected market areas. It is my belief that the rivalry of the open market place disciplines more effectively than do the regulatory processes of the commission. If the managements of utility companies doubt this belief, I suggest that they re-examine the history of their industry to discover just who it was that provided most of the force behind the regulatory movement."

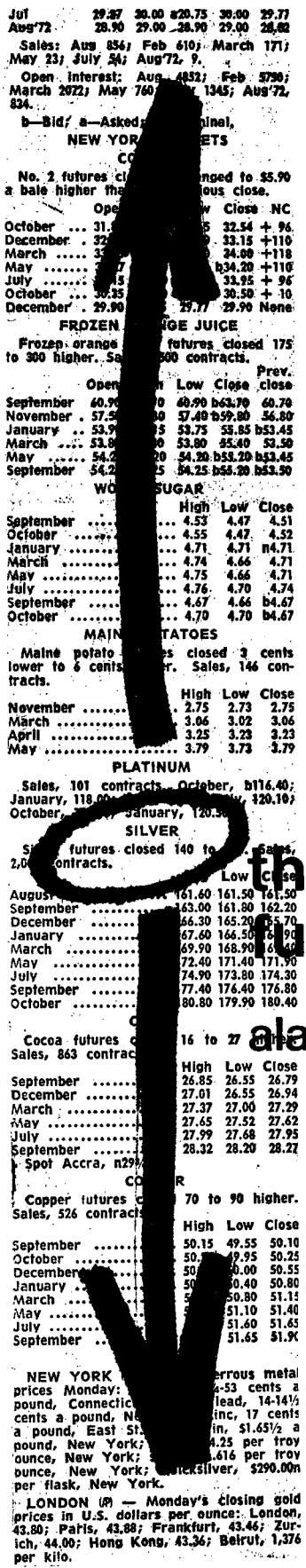
[9] [a] Bork, Robert H., "The Supreme Court Versus Corporate Efficiency," *FORTUNE* (August 1967), pp. 92ff. Professor Bork analyzes the Proctor & Gamble Supreme Court decision and its ramifications, which he calls a "manifestation of long-term trends in antitrust. For roughly the last thirty years, in one antitrust context after another—mergers, exclusive dealerships, patent-license restrictions, price discrimination and so on and on—the Supreme Court has steadily and drastically reshaped the law to protect the inefficient producer at the expense of consumers."

[b] See opinion of Judge Learned Hand in *United States v. Alcoa*, 148 F. 2d 416, 431 (2d Cir. 1945). Judge Hand in effect ruled that efficiency is virtually a crime. His opinion in this landmark case stated: "[Alcoa] insists that it never excluded competitors; but we can think of no more effective exclusion than progressively to embrace each new opportunity as it opened, and to face every newcomer with new capacity already geared into a great organization, having the advantage of experience, trade connections, and the elite of personnel."

[10] *UNIVERSITY ECONOMICS*, p. 325. "Where successful collusions have been carefully investigated, it has been found that special laws, favors, tax exemptions, or government controls have enabled colluding groups to 'police' recalcitrant members and keep out new producers."

[11] See Brozen, Yale, "Is Government the Source of Monopoly?" *INTERCOLLEGIATE REVIEW* V (Winter 1968/9), pp. 67-78. Stone, Christopher D., "ICC"; Peltzman, Sam, "CAB", Hurt, Robert M., "FCC", *NEW INDIVIDUALIST REVIEW* II (Spring 1963), pp. 3-37. Hilton, George W., "The Consistancy of the Interstate Commerce Act," *JOURNAL OF LAW & ECONOMICS* IX (October 1966), p. 87. Coase, R. H., "The Federal Communications Commission," *JOURNAL OF LAW & ECONOMICS (1959). Brozen, "Competition . . . " op. cit.* "The main barriers to entry are those imposed by regulatory commissions, tariffs, quotas, licensing requirements, and some of the activities of the antitrust authorities."

[12] *UNIVERSITY ECONOMICS*, p. 336. "Without laws restricting entry to the profession, there would be many more doctors of lower quality. It can be contended that there would be *fewer* deaths if lower-quality *and* hence more mediocre medical aid were available, because at the present time even worse substitutes are used—nurses, druggists, books, self-medication, faith-healers, friends, hearsay, phone calls instead of personal inspection, not to mention *no* medical attention at all."



Jul 29.87 30.00 e20.75 30.00 29.77
Aug'72 28.90 29.00 28.90 29.00 28.82
Sales: Aug 856; Feb 610; March 171; May 23; July 54; Aug'72, 9.
Open interest: Aug 4852; Feb 5750; March 2072; May 760; 1345; Aug'72, 834.
b—Bid; a—Asked; nal,
NEW YOR ETS
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No. 2 futures cl nged to $5.90 a bale higher tha ous close.
Ope w Close NC
October ... 31. 32.54 + 96
December . 32. 33.15 +110
March ..... 33. 34.00 +118
May ..... b34.20 +116
July ..... 33.95 + 96
October ... 30.35 30.50 + 10
December . 29.90 29.77 29.90 None
FROZEN GE JUICE
Frozen orange futures closed 175 to 300 higher. Sa 300 contracts.
Prev.
Ope Low Close close
September 60.90 60.90 b63.70 60.70
November . 57.5 57.40 b59.80 56.80
January .. 53.9 53.75 53.85 b53.45
March 53.8 53.80 55.40 53.50
May 54.2 54.20 b53.20 b53.45
September 54.2 54.25 b56.20 b53.50
WO SUGAR
High Low Close
September 4.53 4.47 4.51
October 4.55 4.47 4.52
January 4.71 4.71 n4.71
March 4.74 4.66 4.71
May 4.75 4.66 4.71
July 4.76 4.70 4.74
September 4.67 4.66 b4.67
October 4.70 4.70 b4.67
MAIN TATOES
Maine potato s closed 3 cents lower to 6 cents r. Sales, 146 contracts.
High Low Close
November 2.75 2.73 2.75
March 3.06 3.02 3.06
April 3.25 3.23 3.23
May 3.79 3.73 3.79
PLATINUM
Sales, 101 contracts. October, b116.40; January, 118.00 ry, 120.10; October, January, 120.5
SILVER
Si futures closed 140 to Sales, 2,0 ontracts.
Low Close
August 161.60 161.50 161.50
September 163.00 161.80 162.20
December 166.30 165.20 [illegible]5.70
January 167.60 166.50 [illegible]6.90
March 169.90 168.90 [illegible]9.40
May 172.40 171.40 171.90
July 174.90 173.80 174.30
September 177.40 176.40 176.80
October 180.80 179.90 180.40
C
Cocoa futures 16 to 27 [illegible]
Sales, 863 contrac
High Low Close
September 26.85 26.55 26.79
December 27.01 26.55 26.94
March 27.37 27.00 27.29
May 27.65 27.52 27.62
July 27.99 27.68 27.95
September 28.32 28.20 28.27
Spot Accra, n29
CO R
Copper futures 70 to 90 higher.
Sales, 526 contracts
High Low Close
September 50.15 49.55 50.10
October 50. 49.95 50.25
December 50 .00 50.55
January 50 .40 50.80
March 5 50.80 51.15
May 51.10 51.40
July 51.60 51.65
September 51.65 51.9
NEW YORK errous metal prices Monday: -53 cents a pound, Connecti lead, 14-14½ cents a pound, N inc, 17 cents a pound, East St in, $1.65½ a pound, New York; 4.25 per troy ounce, New York; .616 per troy ounce, New York; icksilver, $290.00n per flask, New York.
LONDON (R) — Monday's closing gold prices in U.S. dollars per ounce: London, 43.80; Paris, 43.88; Frankfurt, 43.46; Zurich, 44.00; Hong Kong, 43.36; Beirut, 1,376 per kilo.

the silver futures debacle

alastair mac leary

REASON this month inaugurates a new feature, which will appear from time to time: a column of commentary and advice on various aspect of investment. Alastair MacLeary is one of the new breed of young, mathematically oriented investment analysts. His current interests center on the use of computer analysis on commodity trading. Mr. MacLeary commences his column with a look at the gullibility of some libertarians regarding silver investments.

Fundamental analysis of expected supply/demand relationships is a useful tool for predicting forwardization of prices of a commodity only when at least the following conditions hold:

1. Speculation in the commodity is closely tied to the economic interests producing and utilizing the commodity. That is, the futures market in the commodity has as its primary function provision of liquidity for the economic interests. Speculative interest in the silver futures markets, for example, enables *producers* of silver to ensure that their product will be sold when produced in the future at a price they can determine today and the *users* of silver, say for the semiconductor industry, to ensure that they will be able to obtain silver when needed.
2. Factors affecting the supply and demand of the commodity are relatively predictable. If the users of a commodity are not tied in to the defense industry and consumer demand is relatively constant or slowly increasing (as with wheat), reasonable predictions can be made on the demand for the coming year. If the commodity is some rare metal or, like copper, a metal used high in the structure of production, major perturbabions, such as defense cutbacks or a recession will cause wild decreases in the demand for the commodity. Government use in activities influenced by controversal political decisions, such as minting of silver coins or the amount of the defense cutback or devaluation will cause the demand to be unpredictable.
3. Major uses of the commodity do not have a propensity to be tied to the latest technical developments. A new alloy, for example, may make silver entirely obsolete in electrical conduction. On the other hand, it may greatly increase the electrical demand for silver. A fad may greatly increase or reduce the amount of silver demanded for jewelry.

SILVER—UP AND DOWN

Unfortunately, the commodity in which libertarians speculate most is that very same commodity which least fulfills these three conditions: silver. Additionally, as I have discussed in my articles for *COMMODITY JOURNAL, JOURNAL OF COMMODITY TRADING, and SILVER MARKET LETTER,* the method of price prediction used by fiscal conservatives and most libertarians is of the most naive fundamental type. Depending on only one fundamental prediction for a change in the demand—a devaluation, premier political maneuver—libertarians have invested in waves since 1967.

That this prediction was false is now known. What is less known is that even were the prediction correct, the chances are only very small that the price, after initial shock (remember, after the government's announcement of the two-tier gold market, the price of gold rapidly increased for a couple weeks then decreased *below* previous levels), would have increased beyond the high price of over $2.50 per troy ounce of June 1968.

Currently the price is about $1.65 per troy ounce; after three years of inflation, the price in 1968 dollars is perhaps $1.45 per troy ounce. Even the current price represents speculative interests far exceeding any economic requirements (once on Commodity Exchange in New York, three times the United States' annual production of silver, or one-half the world's annual production of silver, changed hands in one day's trading. And the Commodity Exchange, albeit the largest, is only one of four organized silver futures markets in the United States. The others are the Chicago Board of Trade, the West Coast Commodity Exchange, and the American Board of Trade).

The price of $2.50/troy ounce more than compensated for the increase in economic value were a devaluation to occur. Probably a devaluation, after the initial shock and temporarily increasing prices, would have been followed with a *price decrease* in silver, only one that was smaller than the actual decline that has occured since June 1968, the difference in the declines approximating the amount of the devaluation. An explanation of the artificially high prices for silver since 1967 is offered below.

TWO CLASSES TO CONSIDER

If one is to speculate in commodity futures, or spot commodities, he must distinguish two broad classes traded in organized commodity exchanges. The first class is those for which speculation is at least not grossly distorted from its economic function of providing liquidity and predictability for producers and users of the commodity; the second class is those in which much of the speculation serves other than economic functions—a sophisticated form of gambling, political expression (silver!), curiosity regarding the futures markets (Maine potatoes) or some fad (pork bellies were as now live beef cattle is, the fad commodity, while everyone was investing in IBM stock several years ago).

Included in the first group are commodities such as wheat, cotton, cocoa, sugar, live hogs, oats, corn, soybeans, soybean oil, soybean meal, coffee, and copper; best representing the second group are silver, Maine potatoes, pork bellies, live beef cattle, frozen orange juice, and lumber.

The most rigorous attempts to predict forwardization of prices of a commodity of the first class, based on rigorous mathematical interpretations of international commodity agreements between governments, black market leaks, supply of stock in storage, expected demand, and expected production, has been performed at the University of California at Berkeley in the cocoa market and by the Food Research Institute Studies at Stanford.

Based substantially on the theory of storage developed by Brennon and others associated with the Chicago Board of Trade, it was a regression equation giving the future price as a function of several dependent variables. The constants in the equation were determined by the least-squares method. The least-squares method finds those constants for which the sum of squares of the differences between the analytic predictions and the historical prices actually occuring is least. Yet the correlation between the actual and analytic prices was only 0.66 (for the cocoa market) which if applied to speculation would prove disastrous. The cocoa market was used at UC-Berkeley as it is a far more stable commodity than most. Markets such as silver would have analytic predictions so far diverging from the actually occuring prices that the equations would be ludicrous as anything but an exercise in a problem set for a statistics class.

PREDICTIONS?

When speculators enter the silver market, they make implicit regression analysis, i.e., they predict a future price based on primitive, one might say intuitive (libertarian conventional wisdom!), expected supply/demand ratios. We have seen that even rigorous, mathematical regression analysis does not work, let alone the intuitive, conventional wisdom variety.

Why? Because the supply/demand ratio is inadequate to ascertain the actions of speculators who are using the market to express something besides their expected supply/demand ratios. A number of economic factors enter the market as parameters via the speculators, factors which determine not only the number of marginal speculators, but the size of the marginal speculation. These conditions include, among many others, monetary conditions and monetary policy, the degree and intensity of relative inflation in other nations, actual or anticipated government intervention in the marketplace, wars, labor unrest, changing technology, foreign competition, substitute goods, and the kinds of people who are helped or hurt by government redistribution of resources.

The whim factor was highly relevant to the debacle in the recent silver market: It became popular among fiscal conservatives and libertarians who were displeased with government monetary insanity, especially during the silver certificate phase-out, to enter the silver market as a means of expressing their dissatisfaction and, in many cases, fright. The rightist financial advisors leaped at the opportunity to make substantial monetary profits for themselves by influencing the actions of libertarians and conservatives who wanted a behavioral correlate to their political outrage. They sold books by the tens of thousands and issued advisory letters by the hundreds of thousands, all suggesting that monetary profits were to be had simultaneously with expressing political outrage by investing in the silver market. By and large, since the 1968 high price, over $500,000,000 has been lost by silver speculators. Undoubtedly a large portion has been lost by fiscal conservatives and libertarians. Only the advisory services and the would-be financial messiahs have profited in the silver market in recent years.

NONECONOMIC EMOTIONS

The silver market thus provided an emotional outlet for a large number of people; for them, the market had a noneconomic as well as an economic function. Speculators were willing to pay almost any price for the psychological satisfaction of expressing their hostility to the government. Consequently, the price, from the economic point of view, was overdiscounted (especially in view of the fact that the Fed was drying up the money supply and industrial production was entering a sustained slump). In order to accommodate the influx of buy orders of those entering the market for psychological reasons, the price of silver increased far beyond what any purely economic analysis would have permitted. Quite literally, a fad developed; it was tribally de rigueur to be in the silver market if you opposed government fiscal and monetary policy. Buying waves developed. Those who bought on the first wave and saw their investment increased in value pointed out to subsequent waves of buyers the "correctness" of speculating in silver.

Eventually, however, the market had absorbed that sub-set of individuals who were buying at any price for psychological and political reasons—and suddenly there were no more people to expand the balloon further. The last wave of buyers found out quickly that they had bought at the top. In the meantime, the predicted and expected "imminent devaluation" failed to materialize. The fad quickly abated and those who had rushed into silver speculation found themselves heavily invested in an overdiscounted market. The market reacted as markets do by reverting to a more economic function, that is, the price fell as those in for political reasons exited. Those who bought at a very high price for political reasons paid for their emotional satisfaction by substantial economic loss.

When speculating in a commodity whose futures market serves functions which dwarf the economic function of increasing the rational allocation of that commodity in the structure of production, the speculation must be regulated by predicting not the relationship of the stock of the commodity to its use but by predicting the reactions of the type of speculators that use the commodity futures for extra-economic activity.

PREDICTIONS

Predicting the behavior of speculators in a futures market is best accomplished not by syllogisms beginning with the axioms of a psychology system but by statistical tests on what has actually occured in the past trading of that commodity in the marketplace.

It is necessary to create operational definitions of one's claims to understanding the behavior of people in the marketplace. In order to make money, one must have at least the following:

1. Quantitatively defined stimuli to which the speculators react. One cannot say, "After a sharp rise in a short period of time, speculators will profit-take and a small decline will fill the gaps." Or, rather, one may say this, and many do, but they don't have any money. What is a sharp rise? Or a short period of time? We must be specific. "If the silver prices in the May contract increase at least such and such in at most so many days, then when those conditions have occured in the data representing the trading of the May contract since 1964 . . . ."

2. The stimuli must be detectible. If we run time series analysis on the relationship between stated unemployment rates, published money in circulation and the price of silver futures during the month the figures describe, our psychology is irrelevant, because the stimuli is not detectible until the response has occured. We might, however, run correlations of the monetary conditions one month and the price behavior of silver futures the *next* month, remembering that while we may find positive statistical correlations, we should not commit the *post hoc ergo propter hoc* fallacy.

3. The predicted response must be operationally defined. A statement such as, "The market did x, so the speculators will get scared," is meaningfree, except to those who wish to lose money. The response must be operationally stated. Given parameter relationship x, since 1964 the average price movement was y in n days, along with a number of other statistically interesting numbers.

That the process of which I am speaking is difficult goes without saying. Most people, including libertarians, like to pretend they know market behavior that they don't know at all. They create a metaphysics of the market, which like all metaphysics is rife with meaningfree, symbolic assertions. They pretend to know the market by giving their ignorance labels: "accumulation," "distribution," "short-term reversal," "market adjustment," "unexpected pressure on the downside." The terms mean nothing People lose money on *them* every day.

In silver, we can obtain at least four prices describing each day's trading. The *WALL STREET JOURNAL* lists the previous day's trading, and daily prices are available from all brokerages that trade commodity futures. An entry in the *WALL STREET JOURNAL* may appear as follows: Silver, New York, May '71:
161.90 162.30 161.40 162.10 -.60
The prices are in cents per troy ounce.

These four prices represent the actual behavior of speculators on one day. The first figure is the opening price; the second the highest price at which silver was traded that day; the third the lowest price at which silver was traded that day; the last is the closing price for that day's trading session. The fifth number represents the change in one day's closing price from the previous trading session's closing price.

STIMULUS–RESPONSE

It is with the accumulation of sequential daily price listings that we design our stimuli, and it is with subsequent listings that we measure our responses.

To test responses to various market stimuli requires a data bank suffienciently large to permit valid statistical predictions. I would suggest the price history of at least two delivery months as far back as 1966, when the silver market became modern—and on a large scale.

It makes sense that a stimulus likely to elicit a response of rapid price movement is one which consists of recent volatility in the price behavior of the commodity. This is experimentally verified. Thus we may test a number of levels of volatility of the prices and measure the market response when such a parameter set occurs. Two tests of price volatility immediately come to mind. The first is measuring how violent intraday trading is, and the second is measuring interday violence. A simple Fortran program can be written to generate these parameters routinely.

Mere printouts of the range and change for each day are only a trivial first step in designing the stimuli, let alone measuring a germane response and performing valid statistical tests on their reliability. We must operationally define high volatility and high price movement and, finding when these parameter sets occur, test subsequent price movements.

Without listing the specific Fortran expressions, let me note that what is required is a measurement of the difference in price levels over a specified time period, a parameter varying that specified time period, and a parameter testing the number of days we are to search for subsequent price movements.

OUTLAY BEFORE INCOME

As an indication of the ultimate complexity of such a search, my current programs testing such patterns and subsequent behavior require about 20 minutes to cover one 250 day contract price history, and this is on a CDC 6400, which is from 2 to 5 times faster than most oderate sized models of IBM 360s. Since computer time costs at least $80 an hour on a 360/40, a check of ten silver contracts would require 80 x 1/3 x 4 x 10 = $1080. And this is only the beginning. At least double this must be spent to reach the level of sophistication to titrate all the possible parameter relationships to what I have written now; and, further, my current programs are only the intermediate stage in my searches for statistical predictions.

The point of this description of my work is to indicate to libertarians that profit production in the silver market is as difficult as profit production in any other form of economic activity: Information costs are considerable and the technology is complex. There is no more reason for a libertarian to expect to make money in silver speculation by refering to the incantation, "A devaluation is bound to occur," or the alternative incantation, "As people lose faith in paper, they will prefer silver and gold," than there is for him to expect to make money in, say, the electronics protection industry by calling forth the magic powers of the incantation, "As the police become more politicized and protect less, people will buy electronic protection devices as an alternative."

WALK–DON'T RUN

Do not be seduced by the siren songs of the high priesthood of the silver cult. Of all the advisory services and commodity letters including silver in discussion, those specifically rightist or libertarian are among the worst, for they know how to appeal to the noneconomic motives of their customers and they do so. Hayden-Stone, Dunn & Hargitt, Commodity Research Bureau, and the Silver Market Letter are four reasonably good predictors of the silver market price movements. Read them and compare their operationally precise statements to

the obscure and ambiguous statements of the movement-oriented advisory services. I feel the subject of silver trading is a relevant topic for discussion in a theoretical magazine for several reasons Libertarians have less money for marginal activities, including the support of *REASON* magazine, because they speculated in silver in large numbers and large amounts due to inadequate analysis (and incredibly easy seduction) by the medicine men of the financial world that belies their own advocacy of reason. These libertarians have confused names with objects, incantations with scientific knowledge. When next impelled to speculate in silver, pretend it is pork bellies, and ask yourself, "If the competence I have in predicting the price behavior of the silver market were the competence I have in predicting the price behavior of the pork bellies market, would I speculate?" If the answer is no, *don't*.

POSTSCRIPT

This article was written several months ago. Several additional comments are now in order. My conversations with commodity analysts for two large brokerages recently bear out the misfortune of the dear cost of confusing ideology and economic prediction. First, silver coins. Two commodity exchanges are trading silver coins, the respective face values being very high. The price of the bags has been inflated far beyond the face value and has increased remarkable since the initiation of trading. The analysts indicate that feedback from their brokers show that the vast majority of trading is being done by politically-oriented, e.g., libertarian and fiscal conservative types, speculators who plan to accept delivery. The coins were originally put up and short sales are initiated still by the very dealers who have always advertised to the ideological speculators. Apparently almost no dealers are speculating long. They are unloading the coins at prices much, much higher than they were charging for the coins through their advertisements just a few months ago. The speculators are bidding not for trading but for delivery. In about a year the market will fade, for the coins will have been delivered at prices the dealers previous to the futures market could never have hoped for. The prices will then decline, and another debacle will have occured, albeit on a much smaller scale than the $500,000,000 debacle in silver bar trading. By Crom, this disturbs me.

Secondly, we have the continuing story of silver futures. They prices this year have been fluctuating in a $.30 per ounce range. Here, too, the ideologs have been getting screwed or, I should say, have been screwing themselves. My analyst friends again say the politically oriented speculators are taking the losses. As soon as the market makes a jump, all the "advisory" services catering to the right-wing say, "See, the apocalypse is come, buy silver to save yourself from the imminent collapse," or a more mild variant. They buy, the price goes up a bit more; more buy, price reaches a plateau; the prices drop to the bottom of the range, the libertarians—conservatives get scared and sell. This has happened four or five times this year. The losses are not trivial. They run to millions of dollars. □

publisher's notes

• NEW JOURNAL OF INTEREST

Despite its many faults as a monopolist and pull-peddler, AT&T generally provides high-quality communications services. Its newest one utilizes the printed page: *THE BELL JOURNAL OF ECONOMICS AND MANAGEMENT SCIENCE*. Although paid for by AT&T, the journal is under the capable editorship of Professor Paul W. MacAvoy of the MIT Sloan School of Management, with the explicit proviso by Professor MacAvoy that he be free to select his own editorial board and establish selection criteria for articles. The purpose of the *BELL JOURNAL* is to "support and encourage the hihgest caliber research" into "the nature of regulated industries and their substantial impact on the economy."

The results to date have been interesting. Although by no means a libertarian journal, it has provided a forum for some views highly critical of government regulation. Volume 1, Number 1 (Spring 1970), contained a critical evaluation of marginal cost pricing by R. H. Coase, editor of the excellent *JOURNAL OF LAW AND ECONOMICS*. Volume 1, Number 2 (Fall 1970), contained a number of interesting pieces, including an analysis of the beginnings of cartelization and regulation in U.S. railroads and a critical study of the full costs of Federal Power Commission regulation. The Spring 1971 issue (already double the size of the two previous issues) leads off with an interesting analysis of the *supply of and demand for* government regulation, written by George Stigler of the University of Chicago. A central thesis of Stigler's paper is that "as a rule, regulation is acquired by the [regulated] industry, and is designed and operated primarily for its benefit."

Copies of the *BELL JOURNAL* are available free of charge to interested persons. Serious students of law and economics should write on their university or company letterhead to the Managing Editor, *BELL JOURNAL OF ECONOMICS AND MANAGEMENT SCIENCE*, AT&T Company, 195 Broadway, New York, N.Y. 10007.

• FOLLOWUP TO PREVIOUS ARTICLE

The unsuccesful British trade embargo against Rhodesia is expected to be lifted by the end of the year. U.S. companies will resume and expand an estimated $20 million in exports. Among the side effects of the embargo is that fact that U.S. companies have been led to buy chromium from the Soviet Union at *three times* the pre-embargo price of Rhodesian chrome. As Dr. Honikman pointed out in his article ("Boycott South Africa?" *REASON*, August 1971), trade is a much more effective (and libertarian) method of effecting change than government-imposed boycotts. □

the godfather

book review

tibor r machan

Understanding does not always entail approval. A doctor may understand a disease very well without approving of it, without believing that it ought to be the condition that should obtain with his patient.

Puzo writes *THE GODFATHER* as a loving doctor would write about his honored patient. Puzo writes to remind us that out of confused and very injurious human traditions men can arise who are the best *in their particular circumstances.*

The heroes of *THE GODFATHER* are incredibly easy to judge in terms of the Objectivist ethics. For these heroes are the most rational, most nearly just, honest productive, integrated, and proud people *in the fictional Cosa Nostra* which is presented within Puzo's work.

It is very important to understand the context of a person in order to be able to judge that person morally. The law of the criminal court recognizes this to some extent—that is why we have the principle "innocent until proven guilty." The same approach must be used within morality: someone is morally innocent until proven guilty of moral evil, not in a court of law but in terms of the most rational moral code available to one, in this case the ethics of Objectivism.

THE GODFATHER is the "don" or family head of an organization whose members are virtually all of Sicilian origin. This organization is by U.S. legal standards criminal. By a standard of objective criminal law it would also be a criminal organization because it violates laws which are designed to protect and retaliate against the commission of unjust use of force, i.e., to protect against the violation of human rights.

The family, however, is the most humane *of all the "families" in existence*. The Don is the most rational of all the Dons. He has long ago learned that the use of force is irrational ninety-nine% of the time. The only time within his context that he approves of the use of force is when the continuance of life for members of his family, including of course himself, is at stake. He is entirely aware of the virtues and vices of the U.S. legal system and, as much as he can overcome his traditional distrust of political authority, he is willing to acknowledge that the U.S. legal system is more just than all others.

The Don's youngest son, who stays away from the family for years before he decides that his tradition has reached into his life irrevocably so he must work with the family, becomes Don a little after the Godfather dies. He moves the family closer and closer to becoming legitimate, *sees* the virtue in that, marries an American woman, educates his sons entirely within the U.S. tradition. He knows wherein the salvation of the family, i.e., himself and those like him, lies; since he is a good leader, a most rational person whose mind accomplishes the most difficult of human tasks: good communication, he moves into his father's position. It is his "destiny"—though interestingly enough, while the old Don still made reference to that, the new Don does not think in terms of that concept because he knows more about what his life means than did the old Don.

It is impossible to tell the whole story in a review. The flavor or atmosphere must do. And the flavor of this work, its attitude, is unbelievably pro-life. In the words of the old Don on his death bed: "Life is so beautiful!"

The characters knew how to feel; they were really in touch—especially the best ones. They felt deeply and they *felt* just as it had to *be*. Puzo's ability to associate feeling with living in all sorts of ways is superior to most modern authors, though frankly by now I have stopped reading most contemporary literature precisely because I could not find writers who lived up even closely to my standards after *THE FOUNTAINHEAD* and *ATLAS SHRUGGED.*

And love—well love is projected with a beauty and an understanding I have not encountered about the subject in contemporary authors, excluding the obvious exceptions and a few others, perhaps. (Not reading novels does not mean that I never *begin* to read them.)

It is interesting, incidentally, that Nathaniel Branden, a practicing psychologist now, should enjoy *THE GODFATHER*. I believe that his ability to understand the relationship between a per-

son's childhood, the tradition within which he was raised, the *psychological* environment—for that is ultimately the only really important environmental factor in a child's life—he had, and his present emotional health, sheds a light upon his appreciation of Puzo's work.

THE GODFATHER is not in any sense a philosophical novel and cannot be fully appreciated if it is read for purposes of learning good philosophy integrated with the experience of good art. The philosophy that obtains is implicit, the sort that Miss Rand has said is implicit in all great artists who are not, however, self-consciously philosophical either in their work or, perhaps, aside from it. □

letters

ORIGINS OF FUNCTIONALIST SOCIAL THEORY

In its June and July, 1971, issues, *REASON* has featured two articles on functionalist social theory: "An Anthropological Perspective on Social Change" by Lynn Kinsky and "Counterintuitive Behavior of Social Systems" by Jay W. Forrester. While generally enlightening and informative, these two articles contain some mis-information on the nature and origins of functionalism.

Lynn Kinsky attributes functionalism to anthropology in both the title and content of her article. However, in the sense that she is using the theory—the study of literate cultures—the term "sociological," rather than "anthropological," should be used. When applied properly, cultural anthropology is the scientific study of the sociocultural systems of *pre-literate* societies; whereas, sociology is the scientific study of *literate* societies, particularly of societies since the Industrial Revolution.

Most of the basic principles of functionalism were discovered and applied by one of the "founding fathers" of sociology, Herbert Spencer, in his *PRINCIPLES OF SOCIOLOGY* (1876-1896, 3 vols.). One may also find anticipations of functionalism in the works of Adam Smith.

Miss Kinsky's bibliography to her article, while helpful, would be somewhat misleading to those wanting a "brief introduction to problems and methods involved in studying literate cultures," since most of the entries are either hostile to functionalist theory or are anthropological in nature. The major aspects of functionalist theory were elaborated by the three other "founding fathers" of sociology: Max Weber, Emile Durkheim, and Vilfredo Pareto.

Since the 1930's, functionalism (also called "structural-functionalism") has been greatly developed and improved upon by American soiciological theorists.

The editor's introduction to Jay Forrestor's article states, " . . . the functional approach to describing social systems *pioneered* by Forrestor represents a major advance in social science methodology." (my emphasis) However, the union of functionalism and General Systems Theory to describe and analyze social systems was pioneered by Talcott Parsons and his associates over twenty years ago.

It is rather astonishing that most libertarians are ignorant of the vast sociological literature which clearly gives support and confirms most libertarian hypotheses on what society is now and what it could be.

It is ironic that the discipline founded by such anti-collectivists and supporters of freedom as Herbert Spencer, William Graham Sumner, Vilfredo Pareto, and Max Weber, is now ignored by libertarians. I fear that too many individualists equate sociology with socialism—which makes as much sense as equating psychology with psychosis. For a social movement such as libertarianism to entirely abandon a social science to its enemies makes as much sense as it would for the United States to abandon the field of nuclear weaponry to the Soviet Union. Either course may be suicidal.

Gerald M. Biggers
Elgin, Illinois

IMMORALITY OF EFFICIENT STATISM

I was very much distressed by the general thrust of the June issue of REASON and especially with Robert Poole's essay. Mr. Poole calls for libertarians to become involved in "think-tanks," presumably so they might influence the government to become a more efficient ("cost-effective") shepherd of what collectivists call the "nation's resources." The basic immorality and strategic inappropriateness of

this position has been demonstrated. I would like to focus on certain aspects of the article.

The cardinal fallacy of the article is succinctly stated by the author. "Despite libertarian rhetoric about the 'predominant irrationality' of our times (which may be true of such *limited* areas as *ethics* and education [emphasis mine]) logical thinking and rationality are very much in vogue in the fields of engineering, systems analysis, and applied (real world) social sciences. What is not in vogue is ideology." We are told in the next paragraph that we must purge our technical studies of any ideological assertion because " . . . It is unfortunately true that there is as yet, in the intellectual and scientific community, no recognition of the existence of a rational value structure." We may present voluminous statistics indicating a significant correlation between rent control and housing deterioration but dare not even imply that rent control is a fundamentally evil violation of property rights. Mr. Poole is asking libertarians to participate in an orgy of social metaphysics. We have all been invited to join the staff of Dr. Robert Stadler.

Mr. Poole apparently neglects the fact that there can be no such thing as *wertfrei* applied research. Think-tanks conduct their research according to predetermined goals. These goals are set by the employer, which is most often the government. If the politicos happen, for whatever reason, to place a high value on improved housing, a think-tank might produce a report hostile to rent control, and the report would, perhaps, be acted upon. (This did, in fact, happen in New York State.) If the government's end is a more devastating means of mass slaughter, the think-tank will devise new weapons systems. We may rejoice when a think-tank happens to generate changes which broaden the sphere of individual liberty, but we ought not look to them for our ultimate salvation. Besides, even given the possibility of profreedom reports by think-tanks, Mr. Poole hardly establishes a case for libertarian involvement. If the think-tank is asked to find means toward improved housing or better rail transportation, and the scientists are as intellectually honest as Mr. Poole contends, appropriate anti-interventionist conclusions should be forthcoming with or without the involvement of morally committed libertarians.

The most potent weapon which libertarians possess is their fervent, passionate commitment to thoroughly consistent ideological ends. As Hayek notes, this "courage to be utopian" was a central factor in the success of socialist movements. Libertarians are in an even stronger position because the values we defend are thoroughly grounded in a rational understanding of the nature of man and of reality. To abandon this moral fervor in order to gain admittance into the *wertfrei* universe of the technocrats, would be, I fear, to seal our doom

Tony Fressola
Staten Island, N.Y.

JULY ISSUE UNDER ATTACK

The July issue of *REASON* was the most petty, macabre, and disgusting "libertarian" publication I've ever received.

Dennis J. Chases's "Atlas Shrugged at Me" is one of the most trivial tales of sniveling ignorance I've ever encountered. . . . Allan Reynold's "The Purge of Chicago Economists" is equally useless drivel. The author seems at pains to protect his (or Friedman's) whims and wishes from hard reality, which *doesn't* compromise . . .

Jay M. Forrester's "Counterintuitive Behavior of Social Systems" might better have been 10 blank pages.
(July 1971) ran an eminently more readable, though equally preposterous,
have been 10 blank pages. *PLAYBOY* (July 1971) ran an eminently more readable, though equally preposterous, account of Dr. Forrester's hallucinations. This article I'd like to dissect a bit, since it has a surface gloss which pretends significance.

The only "enlightenment" the article promises is the statist's discovery that coercive, collective State programs are . . .

> . . . ineffective. Results often seem unrelated to those expected when the programs were planned. At times programs cause exactly the reverse of desired results. *(REASON,* p.4)

For any libertarian, this is no profound discovery. From there, the article is candy floss and roller coasters in the never-never land of global demagogery, because Forrester's goal is to . . .

> . . . come to a much better understanding of social systems, [until then] we should expect that attempts to develop *corrective programs* will continue to disappoint us. *(REASON,* p. 4, my emphasis)

And *who* is "disappointed"? The demagogs?

PLAYBOY distills Forrester's theory to the more explicit analysis:

> . . . that *government* inadequacy is an example of predictable and consistent self-defeating human behavior. His studies had suggested that the human mind is not adapted to interpreting the behavior of social systems, that human judgment and intuition were created, trained and naturally selected to look only in the immediate past for the cause of problem.

How many guesses do you need to determine *who* is going to offer his

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Featuring: RETURN TO REASON by Paul Lepanto; "a layman's introduction to, and organized treatment of, the philosophy of objective reality"; specifically OBJECTIVISM. Mr. Lepanto deals with every aspect of Objectivism from the subconscious, to the nature of emotions, to psychological visibility, to the role of government, to social metaphysics. Excellent as a summary and overview of Objectivism. List: $6.00; SIL PRICE: $5.40.

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THE HIGHER CIRCLES, by G. William Domhoff; subtitled "the governing class in America", this book is about those who have used the government to create, maintain and promote a regimented and controlled politico-economic system in America. The major portion of this book is an excellent systematization of many revisionist historical insights. 367 pp.; $1.95 paper.

RAILROADS AND REGULATION, by Gabriel Kolko; this work investigates the origins of regulation in the railroad industry. Kolko concludes that it was the railroads themselves who were the fountainheads of regulation. 273 pp.; $1.95 paper.

SOCIAL STATICS, by Herbert Spencer; Spencer's best and most systematic political work – the closest thing in print to a systematic non-fiction defense of libertarianism. 430 pp.; $6.00 cloth.

THE MARKET FOR LIBERTY, by Morris and Linda Tannehill; an attempt to show *how* the free market can handle all the tasks usually reserved to the government. Perhaps the subject of more controversy in the libertarian movement than any work published in years. 169 pp.; List: $4.00; SIL PRICE: $3.50 paper.

POWER AND MARKET, by Murray N. Rothbard; the most rigourous and far-reaching critique of State intervention into the economy ever written, going far beyond the works of Hazlitt and Mises. Includes a chapter defending anarchism against limited government. 225 pp.; $6.00 cloth, $3.00 paper.

THE UNIVERSITY UNDER SIEGE, ed. by Jacquelyn Estrada; a collection of essays by various students of Objectivism (including Tibor Machan and Lanny Friedlander) on the New Left and the state of modern universities. 280 pp.; $2.95 paper.

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calculated foresight into "social systems" and save the day for "self-defeating human behavior" that has "not adapted"? Less than one.

Even totally out of this totalitarian context, Forrester's "computer models" are no more than imbicilic scribbles. They employ the obvious to lend credence to the preposterous. The amusing "spaghetti and meat balls" of his "world model" have a singular unidentified ingredient: 55 little circles that continuously split lines and produce arrows from nowhere. What are they? Obviously, they are options, decisions, and the applied priorities of individual human beings. *Which* human beings? *PLAYBOY* (not *REASON*) gives the answers:

> . . . under the direction of Professor Dennis Meadows, a team of nine *researchers* at MIT was being recruited to examine *Forrester's* theories . . . Meadows went to *specialists* for evaluations of the exact quantitive influences. (*PLAYBOY*, p. 114)

Is *freedom* a "quantitive influence"? "Influences" on *whose* decisions? What kind of "influences"? Taxation? A gun? *Blankout!*

The implications seem obvious.

What is not obvious is Forrester's superhuman capacity to calculate and graph the "quality of life"—not for an individual, a neighborhood, or a nation but for the *entire world!*

I was enthralled to find that the "quality of life" was about 0.95 in 1929! Indeed, I'm fortunate to have been born when the "quality of life" was at its 1.05 peak! I wonder if I was averaged with Mao Tse-Tung or Ayn Rand?

I was (of course) delighted to find that my "quality of life" will climb to infinity when Capital Investment drops in about 2070 (graph 2). Certainly, this conforms to *PLAYBOY's* observation that:

> The first thing we learn is that the enemy is our love of growth. (*PLAYBOY*, p. 206)

And, with this knowledge, it becomes readily apparent that:

> The Soviet Union achieved [their higher material standard of living] by arbitrarily denying citizens the immediate fruits of their labor. (*PLAYBOY*, p. 208)

Which certainly points the finger at the villain to be devoured:

> The population explosion and pollution are direct descendants of the old gods—industrialization and science. (*PLAYBOY*, p. 208)

Perhaps my quoting of the *PLAYBOY* article is unfair to Forrester—after all, they lay it on the line. Of course, Forrester has no intention of being quite so verbose. It doesn't seem to suit his purposes. Undoubtedly, his next discovery will be that if *human beings* are classified as "natural resources," all our problems are solved. Such progression is to be expected from technocratic demagogs.

I can find neither rhyme nor *REASON* why I should be subjected to such *crap* in a magazine that claims intelligence.

Bill Westmiller
Barrie, Ontario, Canada

BOYCOTT SOUTH AFRICA? SETTING THE RECORD STRAIGHT

Your publication of my article "Boycott South Africa?" in the August issue of *REASON* included a concluding paragraph that I did not write. Not only is the style out of context (a supposedly rational article should not close emotionally), but it is in serious error, since there are obviously many people and nations for whom the continuation of apartheid is beneficial.

Had the author of that paragraph heeded the message in my article, he (or she) might have realised that the effect of emotionally charged words such as "futility" and "stupidity" is counter-intuitive. Instead of persuading those the author would convert, they merely antagonize.

Terence C. Honikman

REASON REPLIES:

Dr. Honikman is correct. *REASON* regrets its blunder and apologizes to Dr. Honikman.

LETTERS HELP SPREAD THE WORD

Perhaps this idea may be of some use to your readers.

While reading an issue of *MECHANICAL ENGINEERING* magazine, I came across an article on compulsory birth control. My libertarian conscience was thoroughly aroused, and I wrote a letter to the editor which, though I am not a member of the American Society of Mechanical Engineers, was printed.

It occurred to me that this is one way in which libertarians could introduce their philosophy to the reading public, while at the same time obtaining practice in putting their ideas into a coherent form down on paper. Local newspapers and other periodicals could be scanned for collectivist-oriented articles and appropriate replies sent in.

Letters to editors are indeed small contributions to the cause of free men, but they could be a satisfying form of activism for those who lack the brilliance of the major authors but still desire to "spread the word."

David J. Kramer
Fort Belvoir, Virginia

trends

This column reports significant events, publications, and analytical findings associated with the growing rejection of corporate liberalism and the concurrent rediscovery of laissez-faire principles. By reporting and publicizing such items, the REASON community can help ensure that they do indeed represent trends, not merely isolated instances. Readers are invited to submit material for this column.

GARBAGE FOR PROFIT

There is a growing realization of the unsuitability of government bureaucracies for performing public service tasks in our cities. Nowhere is the dysfunctional nature of government services more evident than in New York City, which lurches from crisis to crisis with increasing speed. The focus of much recent attention in New York is the problem of garbage collection. A recent front-page article in the *NEW YORK TIMES* reported the results of a study by the office of Deputy Mayor-City Administrator Timothy Costello analyzing the city's Sanitation Department. The report, noting that private garbage haulers can collect refuse at a total cost of $17.50 a ton—*one-third* of the Sanitation Department's cost—recommended that at least 10% of the Department's workload be immediately contracted out to private firms. "The Department of Sanitation should gradually be reduced in size and scope, and the private cartage industry be given the opportunity to expand," the report stated.

The *TIMES* story went on to document the incredible inefficiency built into the way the Sanitation Department functions. When a new line of trucks was phased in, for example, no one considered instituting a preventive maintenance program. As a result, an average of 35 out of every 100 trucks are out of service at any given time. The 35% "down time" compares with 5% for private carting firms, according to the study. "Private carting firms are generally well-managed (with close supervision of operations) unionized and have modern equipment that they maintain in good working order," the study noted.

Since the *TIMES* story, the call for reprivatizing garbage collection has become a chorus. The respected 89-year-old City Club recently suggested turning over a number of government functions to private enterprise, including "some sanitation services" and much of the city's public works construction. And in July Nick Kazan wrote a brilliant article in *NEW YORK* magazine describing San Francisco's completely private enterprise garbage collection and disposal system. Kazan pointed out that the *total* cost to San Francisco residents for removing 2,000 tons of refuse a day is about $20 million annually, including both garbage collection fees and the city's sanitation enforcement costs. If the same type of private operations prevailed in New York, with 8,000 tons per day, the cost would be around $80 million; the Sanitation Department, however, has a budget of *$391* million! Not only that, but since many restaurants, hotels, and other businesses cannot put up with the Department's unreliable service, many private firms are also in business, bringing the total cost in New York to an estimated $700 million per year. Kazan summed up his description by noting that " . . . San Francisco's refuse collection is entirely private. It works like a charm. The lesson should not be lost on New York."

SOURCES:

"City May Use Private Refuse Haulers," *NEW YORK TIMES*, 6 April 1971.

"City Club Calls for Overhauling of Government Here," *NEW YORK TIMES*, 2 May 1971.

"Can Free Enterprise Speed Up Our Garbage Collection?" Nick Kazan, *NEW YORK*, 12 July 1971, pp. 41-43.

SHORT ITEMS

• Ralph Nader strikes again—right on target this time. His Aviation Consumer Action Project is protesting the price-fixing practices of the International Air Transport Association (IATA), the international goverment-backed aviation cartel. As libertarian economists have long maintained [see Rod Manis' article, "Monopoly" in this issue—Editor], cartels are unstable unless backed up by government force. In this regard, it is interesting to note that the CAB is leading the fight to preserve the cartel in the face of the emergence of competition over youth fares. Nader's group is specifically calling the CAB to task for complicity in price-fixing and for acting in secrecy with the IATA and member airlines. (*AVIATION WEEK*, 7 June 1971, p. 31)

• NSPE breaks ranks—and coercive entry restrictions in engineering receives a setback. For many years the National Society of Professional Engineers has been the leading U.S. advocate of compulsory licensing of engineers. State legislatures complied with this demand early in the century by requiring licensing for much of what constituted engineering at the time (building design, roadways and bridges, etc.). Fortunately, the laws were very narrowly phrased ("concrete-bound") so that the newer engineering fields—electrical, electronic, aeronautic, chemical, automotive, etc.—were not covered when they came into existence, and very few engineers in these fields are licensed. After many years of pushing for universal licensing, NSPE, although not giving up, has opened its membership to *non-licensed* engineers for the first time. The presence of a large number of non-licensed members may go a long way to change NSPE's character and prevent it from becoming a partner of the State like the AMA. (*MECHANICAL ENGINEERING*, October 1970, p. 84)

• Walter Heller advocating the free market? Surprisingly enough, yes. The neo-Keynesian former chairman of the Council of Economic Advisors (under LBJ) has taken a strong free-market stand on several recent issues, including his opposition to the SST and the Lockheed loan guarantee. Less well noticed in the controversy surrounding these popular issues was another Heller pronouncement, this time concerning ways to combat pollution. Pointing out that the use of resources is not free, Heller said that the price must be paid for a cleaner environment. The best approach would be to include such a use charge in the existing pricing system, rather than imposing "chaotic governmental regulation," Dr. Heller told a Resources for the Future symposium. Dr. Heller, who has been there, ought to know. (*CHEMICAL AND ENGINEERING NEWS*, 26 April 1971, p. 11)

• Pennsylvania's new income tax has been declared unconstitutional. In an unprecedented ruling, the Pennsylvania Supreme Court ruled that the graduated feature of the tax, under which those with higher incomes were robbed of a bigger percentage than those with lower incomes, violated a constitutional requirement that violated a constitutional requirement that all taxes be uniform in structure. The Court's decision left the nation's third-largest state literally bankrupt for the second time this year! Not only has the state no money to pay salaries, but also it must pay back the $135 million collected illegally under the income tax law, which it already spent. ("Court Voids New Tax in Pennsylvania," UPI, 25 June 1971) □

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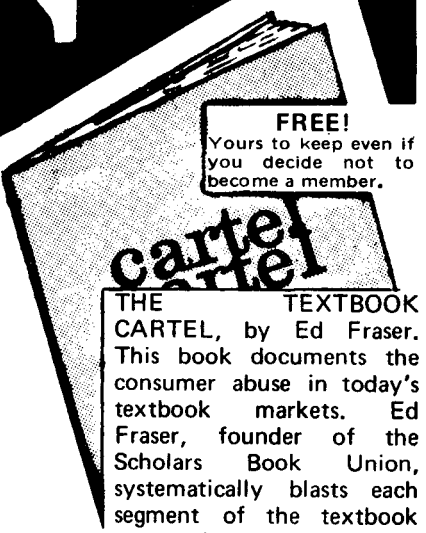

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